

THE INDONESIAN QUARTERLY

Review of Political Development

Indonesia in A Changing Political Economy

Articles

The Impact of the Financial Crisis on Indonesian Women:
Some Survival Strategies

Good Governance, Domestic and Regional Stability:
Agenda for the Future

What Should Be Done About the Haze

The Open and Caring Society: The Challenges
of Information Technologies for Indonesia

Indonesia's Economic Performance Under the New Order

A Review of Current and Capital
Account Liberalisation in Indonesia



The Quarterly

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The Logo



To better represent the underlying ideas that gave birth to the CSIS in 1971 the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, designed by G. Sidharta, it consists of a disc with an engraving that depicts the globe which serves as a background to a naked man with an open book laid on a cloth over his lap, his left hand pointing into the book, his right hand raised upwards. Altogether it symbolises the Centre's nature as an institution where people think, learn and communicate their knowledge to whoever are interested, to share it with them, mankind the world over being their concern and the globe their horizon. The nakedness symbolises the open-mindedness, the absence of prejudice, in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "*Nalar Ajar Terusan Budi*", which in the Javanese language essentially means that to think and to share knowledge are only the natural consequence of an enlightened mind. It is a *surya sengkala*, that is *chandra sengkala*, a Javanese traditional way to symbolise a memorable year in the lunar calendar, adapted to the solar calendar system. It consists in using words that express the perceived meaning of the commemorated year while marking the year at the same time, each word having a numerical value. Thus, the inscription, in reverse order, represents the year the CSIS was established: 1971.

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Review of Political Development

Indonesia in A Changing Political Economy

Ignasius Ismanto

Introduction

THE monetary crisis has not only hit the Indonesian economy but also shaken Southeast and East Asian economies. Indonesia has been the worst hit compared with the other Asian economies. To bring the country out of its crisis, the government had toyed with the idea of a Currency Board System (CBS) which was later withdrawn, and with the reinforcement of a forex tax that was also finally removed. By now, the government has been promoting a series of sweeping programs of economic reform in line with the International Monetary Fund (IMF) agreement signed by Mr. Soeharto on January 15th, 1998.

The monetary woes has had broad implications not only on the socio-economic aspects, such as the increasing number of unemployment and abject poverty, but also on socio-political one as well. For the country, the impact of the economic crisis is much more serious compared with that

of globalization.¹ Soaring prices of essential commodities triggered violent riots across the country.² The worsening economy has encouraged mounting student protests against the government. The escalating student movements backed by other elements of society along with the country's deterioration led Mr. Soeharto to stand down. With the resignation of President Soeharto from his presidency followed by the transfer of power to his successor Mr. B.J. Habibie, the country still has serious challenges in lifting the country out of both its economic and political crisis. This review focuses on the political events in the last three months from March to May 1998.

¹*The Economist*, January 17, 1998.

²The first wave of social unrest blew up in last February two weeks before the People's Consultative Assembly was held. The second one burst in midst of May when President Soeharto left for Cairo.

The Assembly's General Session

A 11-day General Session of People's Consultative Assembly (MPR), held on March 1st through March 11th, 1998, has enacted crucial political decrees. These are (1) the acceptance of President Soeharto's accountability speech (*Pidato Pertanggungjawaban Presiden*); (2) the 1998 state policy guidelines (GBHN); (3) the re-election of incumbent President Soeharto for the next term, 1998-2003, followed by granting him with the emergency power; and (4) the election of Mr. B.J. Habibie as the Vice President. The Indonesian polity, more or less, had already predicted those results. *Firstly*, the draft of state policy guidelines, that was originally drawn up by the dominant faction *Golkar*, had been discussed during the preliminary meeting since last November 1997 and all five factions in the Assembly would not make any substantial changes. *Secondly*, all political parties -- *Golkar*, the United Development Party (PPP) and the Indonesian Democratic Party (PDI) -- had renominated Mr. Soeharto for a seventh successive term. There were also indications of support for Mr. B.J. Habibie's nomination as the Vice President even before the General Session began. The only unexpected event was the political stance of PPP which refused to explicitly accept or reject President Soeharto's accountability speech delivered on March 1st, 1998.

The Assembly's General Session which was held in the midst of a catastrophic economy failed to pay much attention in recognizing the underlying factors of the crisis. Only members from PPP and PDI, both the minority factions in the Assembly, did remind the seriousness of eco-

nomic crisis. They suggested the importance of political reform in line with economic reform to overcome the crisis. The sooner political reform was to be implemented, the faster economic recovery would take place. The bottom line of political reform is to revamp the political system in response to the political dynamics of the dramatically changing Indonesian economy.³ One aspect of political reform should be directed to revitalize the supra-structure in the political system, especially the role of the House of Representative (DPR) and the People's Consultative Assembly (MPR) in a functioning democracy. Mr. Alfian Darmawan and Mrs. Khofifah Indar Parawansa, both from the PPP fraction, argued that the mechanism of popular sovereignty had not worked democratically.⁴ The weakness of such mechanism was expressed by the lack of freedom among individual members in both DPR and MPR. Some observers argued that "recall" and other internal regulations within DPR and MPR were responsible for the poor mechanism of popular sovereignty.⁵

³Some scholars also suggest a political reform of the Indonesian political system, see: Nurcholis Madjid in *Indonesian Observer*, April 4, 1998; Arbi Sanit in *Merdeka*, April 20, May 25, 1998 and in *The Jakarta Post*, May 29, 1998; Manuel Keisepo in *Kompas*, May 5, 1998. Even some suggest a greater demand political reform including the limiting number of successive presidential term to two five year period, see: Hermawan Sulistiyo in *Pilar*, Number 02, January 21 - February 23, 1998; Deliar Noer in *Indonesian Overseer*, March 6, 1998; Siswono Yudhohusodo in *Indonesian Observer*, March 11, 1998; Miriam Budiardjo, Ismail Sunny, and Harun Alrasyid in *The Jakarta Post*, April 1, 1998.

⁴*Kompas*, March 3, 1998.

⁵See: Prof. Sri Soemantri in *Media Indonesia*, March 1, 1998; Prof. Meriam Budiardjo in *Kontan*,

With reference to the 1998 Assembly's General Session, for example, the Chairman of Golkar Mr. Abdul Gafur would imposed a recall to the members of *Karya Pembangunan* (Golkar faction in the Assembly) who interrupted the nomination of Mr. B.J. Habibie as Vice President.⁶ Recall is not a new phenomena in Indonesian politics. It has been imposed to the former members of the House of Representatives and the Assembly, such as Sri Bintang Pamungkas and Bambang Warih Kusumo who were strong critics against the government. In those cases, "recall" should not have been imposed to members of DPR and MPR who perform their function, except to those who violated the criminal law. Without any freedom of individual members, the House of Representatives and the People's Consultative Assembly would function as a political mechanism which only favour parties sovereignty rather than the sovereignty of the people. To eliminate recall toward members of DPR and MPR is a crucial aspect of the political reform in empowering those legislative bodies.

Another aspect of political reform is to revise the infrastructure of the political system. A challenge of democracy in Indonesia is the promotion of political participation. Preserving a floating mass and mono-loyalty of public servants is no longer relevant to the growing political dynamics for this country. Political reform is urgent to eliminate such depolitization.⁷ Society

should be allowed to have political choices. Under the existing political system, both PPP and PDI are unable to get in touch with the grass-roots. Therefore, PPP and PDI suggested an overhaul in the political laws that would hinder democracy. These political laws include the law of General Election, the law of Political Parties and Golkar and the law of Mass Organizations. The revision all of those political laws should be made extensively.

Clean and good governance is another crucial issue along with the country's worsening economy. All factions in the People's Consultative Assembly are committed to eliminate corruption, collusion and nepotism. A House member of PPP, Ahmad Muflich Saefudin suggested that combating nepotism should be conducted not only within the government bureaucracy but also on the legislative body. He indicated that "the nation's highest legislative body, MPR, was dominated by government officials and supporters. No less than 575 of its members are appointed by the President. All governors, military commanders and cabinet ministers as well as some of their spouses and children are members of the legislative body".⁸

Soeharto's New Cabinet

President Soeharto officially announced a 36-member cabinet in March 14th, 1998. The new cabinet would face heavier and complicated challenges compared to the previous ones. The biggest challenge of

Number 28, April 4, 1998; and Dr. Nurcholis Majid in *Indonesian Observer*, April 29, 1989.

⁶*Media Indonesia*, March 1, 1998; *Forum*, Number 25, March 23, 1998.

⁷*Kompas*, March 5, 1998.

⁸*The Indonesian Observer*, March 12, 1998. For more detailed of a rampant nepotism in the Assembly, see: *Republika*, March 26, 1998.

the new cabinet is how to end the economic crisis and restore national and international confidence. He appointed an economic team which included (1) Mr. Ginandjar Kartasasmita as the Coordinating Minister of Economy, Finance and Industry; (2) Mr. Fuad Bawazier, the former Director General of taxation, as Minister of Finance; (3) Mr. Muhammad Hasan as Minister of Trade and Industry, and Mr. Syahril Syabirin as Governor of Bank Indonesia. On security and political affairs, he named (1) General (retired) Faisal Tanjung as the Coordinating Minister of Political and Security Affairs; (2) General (retired) R. Hartono as Minister of Home Affairs; and (3) General Wiranto as Minister of Defense and Security. He also placed his daughter, Mrs. Siti Hardiyanti Rukmana as Minister of Social Affairs.

Soeharto's new cabinet raised pessimism at home and abroad on the seriousness of the country's commitment in pursuing its liberalizing economy. The first reason was due to the removal of virtually all pro-market technocrats in lining-up the new cabinet.⁹ Some cabinet ministers who inclined towards greater state intervention to support domestic industry earned influential positions in policy-making.¹⁰ Another reason was due to the appointment of a new Industry and Trade Minister, Mr. Hasan. He was head of the Indonesian Wood Panel Association (APKINDO) which

was supposed to be removed according to the 50 points IMF program.¹¹ Mr. Hasan is also the Chairman of PT Nusantara Ampera Bhakti (Nusamba), an investment company that is 80 per cent owned by Mr. Soeharto, 10 per cent by the President's eldest son, and 10 per cent by Mr. Hasan himself.¹² The appointment of several people with heavy business interests in the new cabinet would also bring conflict of interests.¹³ This would have a negative image for the country in promoting transparency.

It is President Soeharto's prerogative to decide on whom he wants in his cabinet, even though it is possible for him to ask inputs from society in naming new cabinet formation. Far Eastern Economic Review identified that most cabinet members were associated with Soeharto's own preference, and only some with Mr. B.J. Habibie and Mrs. Rukmana, while the rest lies within Golkar.¹⁴ The appointment of his daughter Mrs. Rukmana has born the brunt of criticism. A number of public figures argue that the appointment of Mrs. Rukmana indicated the existence of nepotism.¹⁵ Nepotism has recently become the

¹¹*Sunday Times*, March 15, 1998; *The Strait Times*, March 17, 1998; *The Asian Wall Street Journal*, March 17, 1998.

¹²*The Asian Wall Street Journal*, March 17, 1998.

¹³See: Sjahrir in *Harian Neraca Ekonomi*, March 19, 1998; Rizal Ramli in *The Jakarta Post*, April 21, 1998.

¹⁴*Far Eastern Economic Review*, March 26, 1998.

¹⁵See: Mr. Amin Rais, the influential academic and the leader of Moslem Organization Muhammadiyah, in *The Jakarta Post*, March 16, 1998; Mr. Nurcholis Madjid in *Harian Ekonomi Neraca*, March 26, 1998.

⁹Among the economists had suggested that the new cabinet had to be pro-reform to bring the country out of economic crisis. See: Prof Emil Salim and Prof. Muhammad Sadli in *Indonesian Observers*, March 8, 1998.

¹⁰*The Indonesian Observer*, March 13, 1998; *Sunday Times*, March 15, 1998; *The Strait Times*, March 17, 1998.

main target of political reform to be dismantled along with the deteriorating economy. Nepotism is a kind of political corruption that is responsible to the encroachment of a strong economic foundation in most developing countries. Only in an authoritarian political system would dirty practices of corruption, collusion and nepotism be resistant. A survey conducted by PERC (Political Economic Risk Constancy), a research institution based in Hong Kong, indicates that Indonesia has become the most corrupt country in Asian economies.¹⁶ Part of it was due to nepotism.¹⁷ Therefore, the promotion of clean and good governance, as reinforced by all factions in MPR, should be an integrated part of political reform to bring the country out of the economic turmoil.

In response to the political demand of clean and good governance, President Soeharto instructed all ministers, governors and high ranking officials to report their private wealth. The idea of this instruction is not different substantially from the previous one.¹⁸ Analysts argue that without providing legal sanctions, any instruction would not be an effective deterrent. To make the new instruction becomes effective, Chairman of United Indonesian Lawyers (IKAHI), Mr. Luhut Pangaribuan, proposed:¹⁹ (a) the establishment of an inde-

pendent body that should audit regularly the private wealth of ministers, governors and high ranking officials; and (b) the result should be announce to the public. Combating corruption, collusion and nepotism is not a new political agenda for the country. A daily newspaper, *The Jakarta Post*, argues that "the failure of government to dismantle corruption, collusion and nepotism is not much because of its inability, but because of structural imbalances in the state institutions. The legislative and judicial branches have been virtually powerless against the overriding power of executive branches".²⁰ From that point of view, problem of corruption, collusion and nepotism is not an administrative reform *per se*, but it also covers political reform as well. Empowering the House of Representatives in keeping clean government would be the most crucial aspect of political reforms for the country.

Students Movements

Thousand of students universities, joining on campus demonstration over the country's deepening economic crisis, broke-out in many parts of the country. These demonstrations have emerged as a moral force that echoed the suffering of Indonesian amidst the current catastrophic economic crisis. No wonder student's voice is identified as popular voice. Along with the ending of the Assembly's General Session, followed by the announcement of Soeharto's new cabinet, students protests have become more vociferous. Besides calling for action to lower the essential com-

¹⁶*Republika*, April 6, 1998; *The Jakarta Post*, March --, 1998.

¹⁷*Republika*, April 6, 1998.

¹⁸The Presidential Decree Number 33/1986 instructed all civil servants to make a report of their private assets. They must inform in a confidential report: for high ranking officials to the President, and for the low ranking one to their superior.

¹⁹*The Strait Times*, March 3, 1998.

²⁰*The Jakarta Post*, March 6, 1998.

modities prices, they demand economic, political and judicial reforms. They also urge the elimination of dirty practices of nepotism, corruption and collusion immediately. The full restoration of the economy can not be effectively accomplish unless nepotism, corruption and collusion are eliminated. They believe without any serious reforms, the future of the country will get worse. Students' demands in conveying people's aspiration have gained public recognition from their senior alumni, scholars and other elements of society. To dismiss students' voices and let their voices evaporate would only bring the country into calamity.

The Minister of Education, Prof. Wicaksono Arismunandar imposed a ban on practical politicking on campus and warned that stiff sanctions including expulsion awaited for those who violated the ban. The outgoing protests, however, escalated to radicalism when they saw that there was no positive response from the authorities. In some places: Surakarta,²¹ Lampung,²² and Yogyakarta,²³ the demonstrations turned into violent clashes between students and security forces. The wake of such incidents were followed by the disappearance of some activist students. There were fourteen activists missing since the aftermath of recent student demonstrations in

February 1998, four of them have returned to their family.²⁴ The National Commission on Human Rights, the Indonesian Legal Aid Foundation and the government are recently investigating these disappearances.

Facing the mounting political demands, the Armed Forces offered a dialog with students and other government critics including Ms. Megawati Sockarnoputri, the ousted leader of the Indonesian Democratic Party, Mr. Amin Rais, the chairman of Muslim Organization Muhammadiyah, and Mr. Abdurrahman Wahid, the leader of Muslim Organization Nahdlatul Ulama.²⁵ A dialog involving 16 cabinet ministers, officials and students was organized by the Ministry of Defense and Security in April 19, 1998. The editorial of *The Jakarta Post* commented this moment as "a positive gesture of the security officials in the barren of political system in which the House of Representatives has demonstrated its lack of sensitivity for the nation's plight".²⁶

People hope that the House of Representatives should play a greater role in accommodating people's aspiration voiced by students. Without any further follow-up, the political demand voiced by student campuses across the country would be louder and more radical. The escalating student movement into radical violence would not only make a difficult position for the armed forces in maintaining peace and security but also put students in a

²¹See: *Suara Pembaruan*, March 18, 1998; *Kompas*, March 18, 1998; *Merdeka*, March 18, 1998.

²²See: *Republika*, March 20, 1998; *Suara Karya*, March 20, 1998; *Suara Pembaruan*, March 20, 1998.

²³See: *The Jakarta Post*, April 4, 1998; *Kompas*, April 4, 1998; *Republika*, April 4, 1998; *Suara Pembaruan*, April 4, 1998.

²⁴*Media Indonesia*, April 30, 1998.

²⁵*Merdeka*, March 17, 1998; *The Jakarta Post*, March 17, 1998.

²⁶*The Jakarta Post*, April 16, 1998.

dangerous situation. The tragedy of "Black Tuesday" killing 6 people, four among them are students of Trisakti University has worsened a poor record of human rights for the country. Students have vowed to continue protesting until their demands are fulfilled. Students movements have grown into a formidable force when more intellectuals, some government officials, and social leaders of various elements of the Indonesian pluralistic society are committed to support them. Students movements are getting stronger with the establishment of Council of People's Mandate (MAR) and Indonesian Working Forum (FKI). Students and other elements of society urged total reforms immediately in maintaining a unity of the Indonesian pluralistic society. They also called for President Soeharto to resign in peaceful and constitutional manner.

Soeharto's Resignation

Widespread rioting in Jakarta capital city and other commercial towns across the country in May 14, 1998²⁷ has not discouraged the spirit of reformation voiced by students. Backed by other elements of society, the students urged the House of Representatives to convene special session of the People's Consultative Assembly. The special session should urge President Soeharto to stand down immediately and review President Soeharto's accountability along with a devastating Indonesian eco-

nomical deterioration. In response to the students who had occupied the parliamentary complex for days, Mr. Harmoko, the speaker of the House of Representatives announced that parliament leaders asked President Soeharto to resign. A political tension came up on the surface, when Minister of Defense and Security Gen. Wiranto aroused a conflicting statement asserting that Mr. Harmoko's statement is "an individual opinion, although it is collectively conveyed".

A mounting pressure on President Soeharto's resignation not only came from the students who are echoing suffering people, but also came from members of Golkar parliament Golkar members of the House of Representatives held an internal meeting and the majority of them supported a special session of the Assembly asking President Soeharto to resign.²⁸ The escalating political demand to step down Mr. Soeharto would make his successors in positioning themselves for transition. Analysts say that the nature called by Mr. Harmoko asking Mr. Soeharto to resign -- without the mechanism of special session of the Assembly -- would provide a room for Vice President B.J. Habibie replacing the country's national leadership.²⁹ President Soeharto's announcement of his voluntarily resignation in May 21st, 1998 was very surprising for many people. It was unthinkable and unpredictable since President Soeharto had intended to resuffle his cabinet into a reformation cabinet and to install a National Commission for Reformation. These were

²⁷Such calamitous situation had been deteriorated by (a) an impervious government policy of President Soeharto's economic team by removing fuel subsidies; and (b) bloody tragedy of Trisakti University when President Soeharto left for attending the G-15 summit in Cairo.

²⁸*The Asian Wall Street Journal*, May 22, 1998.

²⁹See: *The Asian Wall Street Journal*, May 15-16, 1998.

announced by the president after he discussed with some Moslem intellectuals and leaders, known as "the team of nine" at Presidential Palace in May 19, 1998.

President Soeharto himself would lead the Committee comprising of public figures and scholars from universities to implement reformation agenda, including the reshuffling of his cabinet. The Committee would hammer out legislative proposal for overhauling the obsolete political system. With the adoption of the new rules, a general election would be held as soon as possible, leading to the selection of new President and Vice President. Mr. Soeharto promised that he would not run for presidency. Analysts say that President Soeharto has failed to get support in naming his Committee. Either the team of nine or other Moslem intellectual leaders declined to be named in the Committee's member. Analysts argue that Soeharto's National Commission for Reformation is "a tactical maneuver to buy time"³⁰ and to stay longer in power by applying "divide and rule" strategy.³¹ Along with a weakening Indonesian economy, Mr. Soeharto's support is going to crumble.³²

³⁰See: Arbi Sanit, "Soeharto to Reshuffle Cabinet" in *The Jakarta Post*, May 17, 1998; Sarwono Kusumaatmadja in *The Strait Times*, May 18, 1998; William Liddle in *The Asian Wall Street Journal*, May 20, 1998; Amin Rais in *The Jakarta Post*, May 20, 1998; Ariel Haryanto and Leo Suryadinata in *The Straits Times*, May 20, 1998.

³¹See: Mochtar Mas'ood in *The Jakarta Post*, May 23, 1998; Ricardo Saludo, "The Secret of Survival", *Asiaweek*, May 29, 1998; Also, see: "Soeharto Unveil Plan for Eventual Resignation", *The Asian Wall Street Journal*, May 20, 1998.

³²See: Mochtar Machsoed in "Soeharto's Support crumbled as Economy Wreaked", *The Jakarta Post*, May 23, 1998.

By taking such an unconventional mechanism, Mr. Soeharto seemed to avoid the possibility of impeachment by the People's Consultative Assembly, the highest constitutional body which gave him the mandate for the presidency last March. An analyst argues that if this option was not taken, Mr. Soeharto would have been "grilled by the Assembly and most likely disgraced".³³ With President Soeharto's voluntarily resignation, Vice President B.J. Habibie, who had opposed the idea of special session of the Assembly demanded by student movements and other reformist proponents,³⁴ replaced Mr. Soeharto's position. His oath of office was taken by the Supreme Court in the Presidential Palace. Even though Mr. B.J. Habibie has implemented his surprising reformation agenda, by reshuffling Mr. Soeharto's cabinet, eliminating anti subversion law, rescinding press publishing licenses, granting amnesty to political prisoners, and calling for a general election within a year, demands for total reform persist. Students and other proponents of total reformation think that Mr. Habibie is not popular domestically and internationally, and as such, will not be able to manage the escalating economic and political crisis. They claim that he is simply "an extension of President Soeharto-era rule".³⁵ They also claim that Mr. Habibie "has failed to recognize to recognize sense of urgency".³⁶ He has been known as a big spender on

³³See: Yusril Ihza Mahendra in *The Jakarta Post*, May 22, 1998.

³⁴See: *Jawa Post*, May 11, 1998.

³⁵*The Asian Wall Street Journal*, May 22, 1998.

³⁶*Far Eastern Economic Review*, June 4, 1998.

inefficient and prestigious national projects -- (not to mention his zigzag economic theory).

The transfer of power from President Soeharto to his successor Vice President B.J. Habibie has raised pro and cons. There are three conflicting arguments over the changing national leadership. The first argues that Mr. B.J. Habibie should take over the presidency until 2003. This is based on article 8 of the 1945 Constitution which stipulates that the vice president replaces the president in the case of his resignation while in office until the end of the tenure. The second claims that Mr. Habibie's administration is only a "transitional government". Its main task is to organize a general election based on new political laws. The third argument asks for a special session of the Assembly to establish an "independent presidium" as a "transitional government". To increase the level of democracy, this argument proposes a replacement of the Assembly members whose recruitment are nepotistic in nature.

Conclusion

Economics and Politics are closely interlinked in Indonesia. Economic prospect would be determined by political decisions. Conversely, political decisions could not ignore a changing economy. The Indonesian economic crisis and the mounting

demand for political reforms along with economic deterioration indicate a close relationship between those two phenomena. The political aspects of the economic crisis root from a crisis of public confidence in the government. The Assembly's General Session in March failed to recognize the underlying factor of the crisis, even though some individual members in the Assembly have tried to remind the Assembly of the seriousness of such crisis. The escalating student protests across the country since the last three months indicate the urgency of political reform. They believe that comprehensive political reforms would bring the country out of its economic crisis.

Soeharto's departure is not the end of total reformation voiced by student universities. The bottom line of political reform is the democratization of all aspects of the nation. A new challenge of Indonesia's post-Soeharto era is to overcome its economic crisis without undermining its political stability. Without a stable regime political that accommodates the growing aspiration of Indonesian pluralistic society, the economic crisis will worsen the economic suffering of the people. A national consensus among conflicting groups is necessary to build a democratic platform. Only with a democratic platform would the country come to a real political stability. The sooner the political stability could be achieved, the faster economic recovery would take place.

The Impact of the Financial Crisis on Indonesian Women: Some Survival Strategies*

Mayling Oey-Gardiner

Introduction

THE year 1997 saw the unfolding of two disasters in Indonesia: the long lasting and severe drought associated with El Nino and the financial crisis, better known in Indonesia as *krismon* an acronym for *krisis moneter* or monetary crisis. This combination has taken both the government as well as society by surprise, leading to rapidly declining living standards and social unrest.

The social problems are likely to have been further exacerbated by such economic policies which have favored imports at the cost of local production, of even agricultural products. Indonesia's heavy dependence on imports was only realized when the Indonesian Rupiah had lost about 80 per cent of its value against the US dollar, and numerous goods disappeared or be-

came inaccessible to most of the people. Take for example the case of soy beans, the basic ingredient for traditional Indonesian foods such as *tempe* and *tahu* or bean cake and bean curd. Not realizing the process over time, Indonesian became increasingly dependent on imported soy beans which are cheaper than locally grown. In Jakarta the *tempe* pieces currently sold are about one-third the size they used to be. Another case concerns chicken meat and eggs. Chicken meat and eggs, which became increasingly accessible and part of the diet of even the poorer segments of Indonesian society, has now become practically inaccessible to the poor. After the Idhul Fitri celebrations, chicken meat prices became between 3 to 4 times as expensive. More recently, prices of eggs have suddenly doubled. Again this is related to imports of inputs of animal feed, including chicken feed.

The financial crisis is now already ten months old, no longer a crisis but rather ex-

*Paper prepared for the Twelfth Asia Pacific Roundtable, Kuala Lumpur, May 31 - June 4, 1998.

tended agony. After a third agreement with the IMF, it has been agreed that subsidised are to be reduced for eventual withdrawal. The government has introduced extreme rises in fuel and electricity prices, in turn further fueling inflation, which, for the first 4 months of 1998 had already reached 35 per cent (*Kompas*, May 7, 1998). This level of inflation was recorded prior to fuel and electricity price rises effective on May 5, 1998, with all its chain effects to other goods and services.

People are forced to learn to live under very different conditions, changing from being very upbeat and positive before the crisis to being depressed and negative today. People are no longer able to plan for the future, not even the immediate future. Insecurity is widespread, not just economically but also socially and politically. People are learning how to live under insecure conditions, unsure where to find the end of the tunnel let alone the light, no matter how dim.

While the rich have to do with less, the poor have difficulties to survive as their incomes and purchasing power rapidly dwindle, some of the goods and services which used to be accessible to the poor are becoming unreachable. The incidence of poverty is rapidly expanding. Between the early 1970s and the middle of the 1990s Indonesia succeeded in reducing the incidence of poverty from 40 to 11 per cent. Based on estimates for 1996, an increase of the poverty line by 25 per cent would raise the poverty incidence to 25 per cent.

Over the past few months, people have already had to adjust to the inconveniences resulting from the crisis, such as rising

prices and declining supplies or availability of earlier taken for granted goods and services. Within households most of the burden is borne by women for they are the household managers as wives and mothers. Women have to make ends meet with increasing limited resources and declining purchasing power, thereby likely neglecting their own personal needs, as care for their reproductive health. Besides, they also have to manage increasing frustrations of household members and the wider community.

In the mean time, employment opportunities or any other income opportunities have been declining with rising numbers of workers being laid off and small business, cottage industries and petty traders unable to find customers due to rising prices and declining purchasing power. Even though the extent of retrenchments is not yet known, guidance can be gained from earlier conditions. According to the 1997 National Labor Force Survey, women made up 40 per cent of the labor force but 50 per cent of the openly unemployed. Even though the sharp down turn did start in the construction sector, employing mostly men, women dependent industries such as textiles, garments, toys, electronics, etc. have similarly suffered from the economic malaise, thus retrenchments have affected women likely more than men. Yet concerns about retrenchments have focussed on men, likely resulting from greater male visibility and also traditional views among policy makers of men being household heads and women only secondary earners.

This paper is an attempt to explore the various conditions of how Indonesian wo-

men have been affected by the crisis and the types of adjustments they have made. The paper shall focus on the major roles women play in society: their reproductive or domestic and private role, their productive and public role, and also their public role in the community, which in an environment of demanding "reformation", women are also announcing their political aspirations.

Women's Reproductive Role

The most commonly associated with women is of course her reproductive or domestic and private role. Like in most East and Southeast Asian societies, Indonesian women too are in charge of household finances. Husbands are expected to hand over their earnings to their wives and women make most daily household expenditure decisions. In their reproductive capacity women are faced with many challenges. As financial managers of households, women have to make ends meet in providing for their families with declining earnings, if any family member has been laid-off, and also declining purchasing power due to continuing rapidly rising prices. Women are also faced with having to make the very hard choices and or accommodating to rising prices for education and health, maybe even to the extent of having to disregard their personal reproductive health needs. Then, women are also not immune from managing frustrations of husbands and children as well as other members of society.

Household management in response to the financial crisis depends, of course, on the household's economic status and savings. While the better off start with cutting

down on entertainment and less essential goods and services, the poor can only be concerned about food for her family first and then maybe health and education of her children. Anecdotal evidence has it that the poor appear to adopt the following stages of strategies, starting with reductions in quality, next quantity and then even frequency.

Consumption

While the super-super rich may no longer be able to fly their private planes for lack of spare parts, the yuppies consume less of such luxury items as brand name clothes, accessories and overseas travel or other entertainment. Importers of brand name clothes claim a decline in sales of between 40 to 50 per cent. Cafes and night spots claim similar declines in incomes of some 40 to 50 per cent. An known interior designer claims that he used to dine out almost every night. Now ask his wife to cook (*The Jakarta Post*, April 26, 1998).

Food

The severe burden on Indonesian women as mothers is reflected in the changes in the consumer price index (Table 1), which rose very sharply especially in February after the Idhul Fitri celebrations when prices were allowed to rise. The highest price rises were recorded for eggs and milk, beans and nuts (raw material for *tahu* and *tempe*), and fats and oils. Compared to January, February prices for these items rose by 71.4, 24.9, and 24.4 per cent, and over the period between July 1997 and March 1998, prices for these commodities had gone up by 107.3, 85.0, and 85.8 per cent respective-

Table 1

PERCENTAGE CHANGE IN COMPOSITE CONSUMER PRICE INDICES
FOR 27 CAPITAL CITIES IN INDONESIA, JULY 1997 - MARCH 1998

Commodity	January-February '98	December '97 - March '98	July-March '98
General Index	12.7	27.1	37.4
Food	16.1	34.8	54.4
Cereals/Cassava	7.8	21.3	47.9
Meat	17.1	41.6	44.1
Fresh Fish	6.5	16.5	23.9
Preserved Fish	13.4	30.8	36.6
Eggs/Milk	71.4	97.7	107.3
Vegetables	7.2	18.4	45.4
Beans/Nuts	24.9	52.6	85.0
Fruits	11.0	39.2	58.0
Spices	2.0	36.2	68.8
Fats/Oils	24.4	55.4	85.8
Soft Drinks	13.2	29.0	38.9
Prepared Foods, etc.	17.5	35.2	52.8
Housing	10.0	18.0	22.8
Clothing	15.6	46.4	54.5
Other	9.3	18.7	25.1

Source: Biro Pusat Statistik, *Indikator Ekonomi*, Jakarta, various issues.

ly. Noticeably, milk, basically a concern of mothers feeding their infants, was never considered a basic food item in the parlance of policy makers who are predominantly male. In Indonesia the basic food items are known by its acronym as *sembako*, for *sembilan bahan pokok*, or nine basic food items, which consist of rice, salted fish, cooking oil, granulated sugar, salt, kerosene, washing soap, textiles, and *batik*. Notice that these commodities are basically the concern of adults and affect men as well. Yet, milk has become a basic food item in the diet of not just the better off, but also the lower middle classes, especially of formal sector working mothers.¹

The middle and lower classes have had to reduce food consumption, this is often started in reductions in consumption of proteins. Mothers, especially working mothers are faced with the difficulty of feeding their infants and toddlers milk. During the worst times in February, milk prices had doubled. Even though since its peak in February, the CPI for eggs and milk had only declined by 4 per cent in March compared to February, prices remain more than

ago when Nestle came to Indonesia with milk products and basically forced it on mothers, especially those giving birth in hospitals or maternity clinics. Earlier there were strong movements against the producers of powdered milk in favor of breast feeding. Yet, the convenience and the possibility powdered milk created for working mothers resulted in fairly widespread acceptance and dependence, a phenomenon difficult to eradicate at present.

¹Granted milk, especially powdered milk, entered the Indonesian diet only about 10 to 15 years

Milk Powder

The very widely reported, not only domestically but also internationally, has been the group of middle class professional women who call themselves *SIP*, or *Suara Ibu Peduli*, for Concerned Mothers. In early March of this year, 1998, they gathered, prayed, sang and also distributed flowers to passers by in front of the Hotel Indonesia, a very busy circle in central Jakarta. These mothers were calling attention of the government to the sudden price rises in milk powder, to between 2.5 to 3 times, at a time when increasingly, especially working mothers, have become depended on powdered milk. Like many other groups, this group too called on the government to lower prices of, in this case, powdered milk.

Of the group of some 20 women, 3 were arrested and taken to the police station for interrogation. Karlina Leksono, the first and only Indonesian female astronomer who only last November 1997 received her doctorate degree in philosophy became an international celebrity overnight. Her picture was printed over all the media covering Asia.

At these prices mothers can no longer afford to provide milk for their infants and toddlers. Even though milk prices have come down, they are still at least twice as expensive as before the crisis. Mothers are being told to revert back to the old ways when there was no milk for children to feed their children *air tajin*, rice water. *SIP* did not only demonstrate but they have also put their concerns into action. They have raised funds to buy milk at whole-sale prices and have distributed this milk at subsidized prices. *SIP* continues its efforts to help poor mothers in need of subsidized milk.

double the index in July 1997.² Milk was used as the symbol by a number of concerned mothers to take to the streets (see box), a strategic entry point to call attention of women's role in the political arena. Other women NGOs also show their concern by raising funds and helping the poor by distributing subsidized food.³

While all mothers worry about rising food prices, socio-economic class differentiates the information they seek in an environment of rising prices and limited supplies. While the better off tend to ask where to get the best buys for meat and chicken, poor mothers worry about their ability to even prepare *tahu* and *tempe*, or at best

²The CPI for eggs and milk was 190.9 in July 1997, 200.2 in December of the same year, 240.8 in January 1998, 412.7 in February and 395.8 in March 1998.

³On May 9, 4 days after the introduction of very steep rises in gasoline and electricity prices,

milk prices have again almost doubled. A can containing 1,200 grams which had already been reduced to Rp 38,000 before May 5, on May 9, the price in the shops has already reached Rp 62,000.

some fish, as side dishes for their families. While the poor are more likely to ask the price of a bottle of oil or a liter of rice, the better off seek information on the number of bottles of cooking or sacks of rice they can purchase (*Suplemen Jurnal Perempuan*, No. 6, February-April 1998: 1).

Interestingly women have not taken up the case of cooking oil, which rose by 24.4 per cent in February and 85.8 per cent over the July 1997 - March 1998 period. In the aftermath of the very steep rises in cooking oil, mothers have reduced consumption of cooking oil. While desirable for those who already consume foods with high cholesterol content, the less advantaged still rely heavily on cooking oil as a source of fat in their diet. In the past, Indonesians depended heavily on coconut oil as cooking oil and a source of fat in their diet. Many rural women knew how to prepare coconut oil. About 10 to 15 years ago, however, factories started to produce cooking oil from other commodities, especially oil palm and to a lesser degree corn, sun flower or other commodities. As *Bimoli* and *Filma* (most widely available cooking oil brands) palm oil dominated the market, the demand for coconut oil rapidly dwindled. Only traditional ways of preparing coconut oil are known, and these are likely inefficient compared to those produced in large scale factories. There are today far fewer coconut trees around and the skills to produce coconut oil are rapidly disappearing. Women, especially poor women, can no longer request their husbands or sons to climb a coconut tree in their garden, which she then processes into cooking oil. It is highly regretted that economic policies and higher education re-

search have failed the Indonesian dietary needs.

Poor mothers have had to give up even the few times a week of serving eggs and a little bit of meat to her family. During the recent annual holidays since Christmas, New Year, Idhul Fitri, Chinese New Year, many mothers were not able to set aside money for their family to buy new clothes. Even road-side stalls were not visited for less expensive clothing. Other unnecessary goods are not even considered by the poor. The basic staple of rice is often mixed or even substituted with corn and or cassava. When household finances become even more limited than the next step is to reduce quantity of goods and services. Mothers are increasingly forced to deny their children's requests for goods and services. In managing the food budget, mothers have been known to reduce the number of dishes and also the amount she serves her family. It has been reported that mothers having difficulties feeding their children have had to reduce frequency of food consumption. During my field visits to a poor primary by the teacher school we were told that a number of children are already listless by 9:00 am. The reason given by the teacher was that these children were not given breakfast.

Health and Nutrition

The Indonesian financial crisis, resulting from rapidly dwindling value of the Rupiah against the US dollar, has also resulted in soaring prices of medicines. Even though there are local pharmaceutical factories producing basic medicine, it was again only then realized how dependent

these factories are on imported inputs, some 90 per cent. Even generic medicines are in short supply. Hospitals and pharmacies have reported shortages of essential drugs as well as difficulties in maintaining costs at affordable levels. The distribution of contraceptives has suffered, affecting women dependent on these fertility control devices. Sharp price increases have undermined the ability of the poor in particular to allocate adequate resources for preventive or curative health care. Women, who most often sacrifice for other members of the family, will likely be most affected by the crisis. The health status of pregnant women is particularly threatened as maternal mortality in Indonesia, even prior to the crisis, was already among the highest in the region. Maternal mortality, estimated at 390 maternal deaths per 100,000 live births, is very high compared to the neighboring countries (Philippines 76, Thailand 37 and Malaysia 34). The current fear is that instead of declining, Indonesian mothers may well be faced with increasing dangers of and inabilities to control maternal mortality.

Similar dangers are associated with poor and declining nutrition status. While the nutrition status of women and children had improved in recent years prior to the crisis, the gains were modest compared to other countries in the region. About 15 per cent of Indonesian newborns are low birth weight and about 35 per cent of preschoolers are underweight and suffer from protein-energy malnutrition. Under five years of age, boys are more malnourished than girls but upon reaching school age and adolescence, girls are more malnourished than boys of the same age. The situation continues to worsen as girls enter childbearing years and be-

come mothers. Maternal anemia is high, more than half of mothers are anemic, another closely associated factor to high maternal mortality.

Education

In April and May, the media widely discussed an immediate problem faced by mothers having to make money available to take the national final examination for their children at the end of an educational cycle, i.e. those in grade 6 of primary school, and grades 3 in lower and upper secondary school. Not only have exam fees been raised by the state, but all additional fees have also risen beyond the means of the poor or even the lower middle classes. Following past practices during the good times, i.e. before the crisis, final exam fees are combined with school fees for the months that school is not in session, and worse in these difficult times, teachers continue planning for festivities and picnics. This practice may well have the effect of mothers giving up and telling their children not to take the final examination. This can have the effect of sharp reductions in graduation rates and, for the next academic year, reductions in transition rates.

In the past, girls have benefitted disproportionately from education opportunities. The gender gap has narrowed over time. The remaining gender differences in school attendance have been primarily caused by differential entrance rates into a new cycle. As the formal sector labor market became increasingly in favor of females, parents were willing to equally invest in their daughters' as well as their sons' education. In the meantime the formal

sector labor market is rapidly crumbling, and women may well be carrying most of the burden of retrenchments. As a result of the additional financial burdens of final exams and then on to entrance fees in the next academic year starting this July 1998, we may well see a return to earlier gender based discrimination by parents, and gender based stereotypes preventing parents from investing in their daughters' education.

Managing Frustrated Household Members

The burden of laid-off husbands is on the wife. During the good times when husbands had their jobs, they were away from home most of the day. As the crisis has resulted in widespread retrenchments, women bear the burden of their husbands staying at home. A recent editorial in one of Jakarta's major dailies, *Kompas* (April 22, 1998) quoted a letter from a woman seeking advice on how to deal with her laid-off husband while she still holds a job and they can no longer afford the services of a maid. The editorial mentioned the conduct of a frustrated husband, who showed no interest in contributing to the required household chores. Instead, he continued sulking and sat around the house. The wife too became similarly frustrated as she still had to do all the household chores after a full and hard day at work. She sought advice on what to do.

The same is true of children. Most of their frustrations are addressed at their mothers, when their desires can not be fulfilled as mothers make most of the daily decisions in the household. Mothers are

more likely to be the ones to have to say no to their children's desires. And, as is still common practice, when children ill-behave, mothers continue to be blamed.

Violence and Crime

Even before the crisis domestic violence was said to be on the rise but the crisis has exacerbated the occurrence. Increasingly women are faced with domestic violence of frustrated husbands. In the past when residential patterns accommodated the extended family, social controls from the extended family prevented domestic violence. Today households are more likely to consist of nuclear families, consisting of husband, wife and own children. Frustrated husbands are no longer prevented to take out their anger against their wives and children. Information from an NGO concentrating on providing legal assistance to women claim a sharp increase in domestic violence cases since the crisis.

Women are also increasingly subject to sexual assaults outside the home. On April 15, 1998, we received a warning sent by e-mail to many other women. A young and fairly independent women took a taxi to go to a bank but was taken elsewhere. She was not only robbed but also sexually assaulted by the taxi driver who claims to suffer from declining customers. Eventually he threw her out of the taxi on the toll road.

Women's Productive Role

Even before the crisis women constituted one-third of the work force but

already half of the openly unemployed. Yet, women continue to be regarded and also regard themselves as only helping their husbands, as secondary income earners. When companies retrench their workers, the usual rule applies of the last hired the first fired.

The crisis has led to widespread retrenchment, including women. Even though it was the construction sector which first started laying off large numbers of workers, who are mostly male, other sectors have not been immune to the down turn in the Indonesian economy. The very sharp decline in the value of the Rupiah against the US dollar, rejected L/Cs and soaring interest rates of more than 50 per cent from the Central Bank, have resulted in the death of many businesses of all sizes. Labor intensive industries and many services, relying on female workers, have had to rationalize and even close down. Many of the labor intensive industries (such as textiles, garments, and leather goods) and services have had to lay off large numbers of workers, but, the full extent is not known because only mass retrenchments from formal sector legal businesses are reported, for such actions require government approval. If in the past, about 40 per cent of the labor force and half the openly unemployed were women, a crude assumption of half of those laid off consisting of women would not be too far off the mark. Until April 1998, the government had given approval for dismissal of some 130 thousand workers which excludes those being temporarily housed and those working or earnings a living from informal sector activities.

Besides, a view from the village suggest a breakdown of the production and distribution system. In rural Indonesia, and more specifically in rural Java, before the crisis traders were predominantly female, albeit mostly as petty traders. The breakdown in the distribution system has therefore also affected women traders, many of whom have gone bankrupt and are forced to stay home, looking for other means to take care of their families.

In addition, in the global economy, Indonesian overseas women workers have also been affected by the crisis, even though so far the media has reported most of those deported from nearby ASEAN economies, particularly Malaysia. Even though the majority of Indonesians working in Malaysia are male on plantations and in the construction sector, women have also gone there to work in factories or as housemaids. As the Asian economies are slowing down, Indonesian workers have been sent home. The most widely reported have been the illegal immigrants deported from Malaysia, and the incident in camp Semenyih on March 26, 1998, when 8 Indonesian workers and 1 Malaysian security officer were killed. According to *SP, Solidaritas Perempuan*, an Indonesian NGO mainly concerned with overseas workers, these Indonesian workers are treated inhumanly. Yet, both the chairman of the *SPSI (Serikat Pekerja Seluruh Indonesia*, the Indonesian labor union) and *SP*, recognize sadly that domestic conditions in Indonesia where there are relatively few employment or income earning opportunities available, such inhuman treatment from the Malaysian authorities has not prevented the desperate to return (*Kompas*, April 27, 1998).

Government Programs for Those Laid-Off

Initially the government introduced a labor intensive crash program to ameliorate the suffering of those laid off. Regrettably, however, the government addressed only the needs of men. The first wave affected by the crisis were the real estate and construction industries, which, granted, are predominantly male. Many of these unemployed construction workers were visible among main roads carrying their shuffles. Their large numbers apparently caused concern among policy makers, who are themselves also predominantly male. Hence when the government introduced a labor intensive crash program it was directed at such men with no provision for women at all. It was only after an NGO, of which I am a member, pointed out to the government that women too have been laid off, that the government has currently introduced a provision for women also. 20 per cent of the budget to created employment opportunities is to be allocated to women workers. Similarly, a program of the Minister for Social Affairs to provide meals for those laid off, are again directed at male workers. Some of these beneficiaries have complained that the transportation cost to obtain the meal exceeds the cost of the meal and that their families remain hungry.⁴

⁴To date, no adjustments have been reported in the media. The only news on this program concerns the larger number of civil servants whose salaries are to be deducted and deposited into the Minister's account as their voluntary contribution to this program. Earlier the President had announced that his and the ministers' salaries are to be donated to the program for one year.

The problem is that many working and income earning women are still regarded and also regard themselves as only *bantu-bantu suami*, helping their husbands, as secondary earners. Besides, women's subservient position in the household is further strengthened by the marriage law which states that men are household heads and women are wives and mothers (Law No. 1(31), 1974, on Marriage). Within this context, the government's response to prioritize men as household heads can be regarded appropriate and legal, even though not necessarily realistic. There is an increasing proportion of women who are *de facto* household heads, whether taking care of themselves only or basically in charge of their households for their husbands may well be away, like the example above, in Malaysia, or elsewhere for that matter.

Public Political and Community Role

But, women's roles are not just limited to their reproductive and productive roles. Even though it is true that women are still far less likely than men to be concerned about politics, the situation in such that increasingly Indonesian women are aware that they too have an important political role to play in their respective communities as well as the nation.

The gathering of the *SIP* at the circle in front of the Hotel Indonesia last February 1998, was a political statement, that women too are concerned about the state of affairs in their country. Also interesting has been the completely different nature of the annual celebrations on April 21. This is the day when Indonesian women commemorate

Kartini, who at the turn of the century was already concerned about women's emancipation. Wives of professors and other women at Gadjah Mada University staged a rally calling on the government for the need for economic, political and social reformation. This rally was chaired by the wife of a noted sociology professor who spoke earlier that day on the plight of Indonesian women who bear the brunt of the current uncertainties and difficulties faced by the Indonesian people.

Some Remarks

The actual gender impact of the crisis is in fact unknown, and therefore stereotypes may well be widespread. While it is true that women as household financial managers are the most affected by declining earnings and rising prices, men as husbands are also equally concerned when they have not brought home sufficient resources for the family to obtain the goods and services they have become accustomed to. On the other hand, as women are affected differentially from men by the crisis and government policies are still often gender blind, I make a special call for the plight of women, in regards to women's reproductive health.

An important lesson learned on gender differences resulting from the crisis concerns the visibility of men and the invisibility of women. Women are socially taught not to hang around while it is considered appropriate for men to be visible in the public eye and therefore draw attention to their existence and their plight. Maybe women too should learn to make themselves

more visible to be given opportunities like men, also benefit from public finance.

Besides, special attention is also called for the plight of women, not as wives or mothers or daughters, but rather as individual human beings. It is often said that in the labor market women are the last hired and therefore the first fired. Similarly it is also often claimed that female children are less advantaged in access to education opportunities. Before the crisis, Indonesian girls were making good progress in education that gender differences have practically been eliminated at the primary and lower secondary levels. Will the crisis change this achievement almost gender equality in human investments? The validity of the assumptions are as yet unknown. Neither is it yet known whether women have been more or less affected than men in the wider economic, social and political turmoil. The facts are still to unravel themselves.

In closing, it is reminded that the crisis is a continuing saga. Besides the already heavy burdens carried by the Indonesian people resulting from the effects of El Nino and the monetary crisis, there is a current epidemic of dengue fever affecting mostly urban residents. Another severe impact of the crisis has been on the availability and price of medicine. As a result it is said that people are lowering the quality of services they purchase. Many of those now seeking treatment at public hospitals used to go to private hospitals. Similarly, doctors' visits at public clinics by new patients who used to go to their private practice, has also been reported to be on the rise. Then, more recently, in the prov-

ince of Lampung, the most southern province of Sumatra, farmers are suffering from the plague, locust destroy their harvest. How these women cope with this additional burden should be further studied.

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Good Governance, Domestic and Regional Stability: Agenda for the Future*

Jusuf Wanandi

Philosophical and Fundamental Questions of Good Governance

THE Asian currency crisis, which has become an economic and a social political crisis, has shown the importance of good governance, both by the state and by the corporate or business world. In fact, it will become a critical factor in preventing such a crisis in the future as well as in overcoming the prevailing one.

First, one needs to have a philosophical understanding about what good governance means, how to achieve it, what are the underlying and related factors, and what are its objectives.

Good governance means that authority is based on the rule of law, its policies are transparent, and its is accountable to the society. It also has to be based on institutions and not on the wishes of men or personalities. It should also adhere to the principle

that all men (and women) are equal before the law.

The economic factors that have caused the East Asian crisis, such as declining competitiveness, weaknesses of financial institutions, the dollar peg of most of the currencies, the lax use of short-term external loans to finance real estate and other non-productive projects, has been compounded by the lack of good governance. This has created further lacunae and holes in what were initially relative sound macro-economic fundamentals. These sound fundamentals were high savings, low inflation, more equitable income, market-orientated and open policies, high investments in education, and non-excessive deficits in current accounts and the balance of payments.

The deficiencies in good governance have resulted in the creation of monopolies, cronyism, nepotism and corruption, which damaged the macro-economic policies of the East Asian government. As a conclusion, therefore, it can be said that the sources of the East Asian crisis are both economic

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and political in nature. The lack of good governance was responsible for the mess. Increased interventions in the conduct of good macro-economic policies have damaged the economy and have created the high cost economy and as well as declining productivity and competitiveness. This lack of good governance has also led to the adoption of wrong policies by the state, such as giving the chaebols an oligopolistic status in South Korea, encouraging monopolies, nepotism and cronyism as well as corruption in South East Asian, most blatantly in Indonesia.

A more philosophical question, but also a real one, is the relationship between good governance and democracy. It was a question, because in the case of Singapore and Hong Kong, good governance has not been accompanied by a mature democracy. The impact of the currency crisis to these two countries has only been limited. What is meant here by a mature democracy is a government based on the rule of law, with regular general elections, which open real possibilities for changing the government, and where the government is controlled by a developed civil society.

Singapore and Hong Kong are exceptions, perhaps because they are city states. In addition, in the case of Hong Kong, as part of China and a British colony for many decades, there is a real separation of economics and politics, and there are some restrictions on the freedom of expression and people's movements, which should be important for a sustained development.

In the case of Singapore, geo-political considerations have placed some limits on the flexibility of the political system. It should be interesting to watch how the

demand by the younger generation for political development will be met and how flexible a one party-dominated system can be.

It should be recognised that in both cases, the concept of Aristotle or Confucius has been put in practice by a clean and clever government. Based on a stringent rule of law that was laid down by Britain, Singapore and Hong Kong have become a model of good governance in the region. This shows that good governance is a possibility in the region. Yet, both are special cases and therefore, could not be emulated in other parts of the region, where politics is much more diversified and complicated due to history, size, diversity, stages of development, and the socio-political dynamism of the society.

In other East Asian countries it will be difficult to separate good governance from democratic developments. This means that good governance cannot really be developed without democracy and democratic development at the same time. This is so because in these other societies there is need for greater flexibility and participation of a diverse society. A democracy, rather than a repressive system, can cope with diversity and the quest for participation and flexibility for a sustained period.

It has been argued that the ideal development is where political development is a step behind economic development, and as such political development will not become a limiting factor for successful economic development. While theoretically this could be valid, because to a certain extent political development brings instability, it should be also recognized that such a political calibration of national development is never easy in practice. It could also be misused as

an excuse to postpone political developments all together.

It can be argued more convincingly that political and democratic development should go in tandem with economics development because economic development will initially create discrepancies and inequalities. This can be overcome only through political development, where democracy or political participation can compensate for the inequalities of economic development while good governance can assure that sound macro-economic policies be adopted. Furthermore, with a few exceptions (Singapore and Hong Kong), good governance could be established only on the basis of democratic processes. Since the ideal type of a government of philosophers, as imagined by Aristotle and Plato, is not feasible, democracy is the only way.

What kind of democracy and how fast to implement it will depend on conditions in each country concerned. The Jeffersonian or Westminster model is not for every society to adopt, as can be seen from the models in continental Europe. But to make democracy work in accordance with its ideals, it should be based on strong civil societies. After all democracy is a form, such as manifested in elections, separation of power and a party system, while its substance is guaranteed by the presence of a strong civil society.

How far and how fast political development should be pursued in East Asia will depend on each country's history, tradition and stages of development. But, let there be no excuses that democracy could be postponed until a certain stage of economic development has been achieved as in the so-called Korean model of development.

A process involving trials and errors could be expected if democracy and political participation are implemented at every stage of economic development. It should be a step by step and gradual process, and some instability is inherent in every development. Therefore, some consensus has to be reached on the basis and process of democratisation. In the case of East Asia there is no excuse to postpone political development, because economic development has already created a critical mass of a middle class that has become the basis for a gradual process of democratisation.

In fact, as said earlier, because economic development creates instability, democracy and political participation is a must. Only through greater political development can governments get sufficient political support, which it would need to overcome a crisis as is happening in East Asia today. This is the case in South Korea and Thailand, in which a change in government, for the better, can lead to an acceptance of sacrifices to be made. While democracies are also having crises, the system is able to adjust and correct the mistakes made and overcome the crises easier and earlier.

Another philosophical question is whether Asian values have worsened the crisis, and whether those values have to be changed and adjusted or abandoned in order to overcome the crisis. The earlier debate on Asian values has not been very productive. One reason has been the arrogance of some of East Asian leaders due to their recent economic prowess. This has been in part a reaction to and to get even with the same arrogance shown by some Western leaders. Another reason is the eagerness to improve on Western values,

which are considered to have extreme individualistic tendencies that could bring about a decline of the societies (crime, drugs and economic decline). While there is some truth in this, it has been pursued exaggeratedly without taking due notice that some efforts to correct this extreme interpretation are being made in the West.

Yet another reason is to use Asian values as an excuse on the part of some of East Asian leaders to impose a more paternalistic and repressive political system, which they consider a *conditio sine qua non* for modernisation and economic development of their societies.

In practice there has never been one, common Asian values, because there is so much diversity in Asia. Some of the principles that are recognised as Asian values, could be universal and were similar to Victorian values that were present in the West earlier. They are values that are formed at a particular stage of development rather than being Asian or Western. Moreover, and perhaps most importantly, these values are changing so much and so rapidly every where. These changes are a result of education, technological improvements, especially in information and transportation, as well as globalisation of the economy. Therefore, it could be said that some convergence is happening among values in the world.

But at the same time it has to be recognised that certain differences will always be there due to differences of history, stages of development, and some cultural traditions. And this should be good for the world. There is, of course and naturally, a certain nationalistic resistance towards this process of global convergence. That is why

nationalism at the same time has been arising as a defense mechanism in many societies.

As a conclusion, it can be said that the relationship between economic development and modernisation on the one hand and values system on the other hand is more complex than recognised during the so-called Asian vs. Western values debate. This cannot be put in simple paradigms such as: "Asian values has compounded the East Asian crisis and therefore has to be changed with Western ones". The existence of Asian values is a matter of debate, and the lack of good governance is not a monopoly of East Asian societies. It can also be argued that the crisis has more to do with stages of development than with values system. As other developed societies has undergone crises before they have reached the developed stages, East Asian societies will go through the same challenges towards maturity. And as other societies have to accept cycles of economic development, East Asians are now experiencing theirs.

The main question to ask is whether they see it in the right way and will be able to rise up to these new challenges and to overcome them. Importantly, whether they do see that good governance has to be an intrinsic part of good macro-economic policies. Furthermore, whether they agree that to be able to achieve good governance, a democratic political system is a *conditio sine qua non*: without good governance there is no possibility of formulating consistent and transparent macro-economic policies; without democracy there is no possibility of good governance to be established. Good governance is very much part of democracy. And while there are some ex-

ceptions, such as with Singapore and Hong Kong, and stages or system of democracy might be different from one nation to another, it should be clear that good governance is the only basis for good macro-economic policies.

The Impact of Good Governance for Domestic and Regional Stability

Based on the examination above, it should be clear that good governance has been the missing part in most of the East Asian countries that have got into a currency crisis. It should also be clear that to overcome the crisis now and to prevent another in the future good governance should be part of the package of policies and actions to be taken.

It also should be clear that good governance is a vital part of democracy, and that only democratic developments can guarantee good governance. Democracy in form alone is not adequate to guarantee good governance. A mature democracy is needed to be able to do that. This is where the rule of law is paramount and that people are equal before the law, and where a civil society provides a guarantee for the adoption of values of a democracy. Ultimately, it should allow for a change of government if people so wish.

In this sense good governance is a vital part of political and democratic development, without which a comprehensive and balanced strategy of development cannot be pursued. This new strategy of development is vital for the future development of East Asia and has been based on the lessons learned from the inadequate and one-sided growth strategy of the last 25 years.

It also has become obvious from the current economic and political crisis that a new strategy of development for East Asia is vital. In the last 25 years rapid growth of 7-9 per cent annually was considered necessary for East Asian regimes to maintain their legitimacy as well as for the region to catch up with the developed world.

The long term economic growth cycle has now come to an end, perhaps normally so. It also has made it clear that rapid economic growth alone is no more adequate for the countries concerned, because in the mean time they have encountered new problems and challenges due to that rapid growth. Therefore new strategies for development has to be established. They should be inclusive, balanced and sustainable at the same time. This comprehensive strategy is vital for East Asian growth and economic development in the future, but also for its stability and security.

Inclusive means participation of the small and traditional people who have been marginalised. A balanced growth means that the Korean model of economic growth first and political development later is out of the question. Sustainable development is now as important an objective of development because without it there could be no development in the future. The haze problem in South East Asia or acid rain in North East Asia have made this a more urgent task, because their longer term damages are greater than the benefits of economic growth.

Political development as part of the new strategy of development means democracy, where good governance is very much a part of it. Without democracy, transparency of policies, rule of law, and social control

cannot be achieved. *First*, successful economic growth will need good governance to be able to lay down sound macro-economic policies. It cannot be overly stressed that the absence of good governance has been partly responsible for the crisis.

But more than that, political participation is a vital part of national development, since this will guarantee that inclusive growth, fair competition and social justice, will become important elements of national development. Inequities have created new instabilities, and this should be taken into account in formulating new strategies of development. To cope with change and instability as a consequence of economic growth and development, only political and democratic development can bring security and stability.

In pursuing good governance and the development of democracy, every country has to find its own pace of development. The Jeffersonian or the Westminster model might not be the right one for East Asia. They could develop democracy in an evolutionary and step by step fashion, but in tandem with its economic development.

The adoption of the so-called Korean model has created a lot of problems in the developing part of East Asia, because nobody knows how and when to start with political development. And more seriously, in many cases it has become the rationale for further postponement of political development until it is too late for a peaceful system of political development to be introduced and implemented.

Compare the cases of Indonesia and the Philippines. Having postponed political development in order to get economic devel-

opment going first, both the Philippines under Marcos and Indonesia under President Soeharto at the end got stuck economically due to political stagnation. It was only after a long struggle that the Philippines becomes a democracy again. After going through a certain transition period of a "messy" democracy, the Philippines is now developing reasonable well. They have done better in dealing with the currency crisis.

In the Indonesian case, the currency crisis was due to economic as well as political factors. But since there has not been progress in political development, and good governance has been absent, the economic and the political crisis has continued and worsened with no end in sight.

In the case of Thailand, initially the economy worsened because of vested interest, cronyism and corruption. But with the change in government, an improvement in governance and adoption of better economic policies have led to a turn around of the economy. Malaysia has a relative good functioning democracy with reasonable good governance, and has been able to make the necessary policy changes to stem the crisis.

South Korea, having an immature democracy as in Thailand previously, has not been able under President Kim Young San to lay down the conditions for good governance, especially in relation to the oligopolistic position of the chaebols, and the inflexibility of its financial policies and institutions. However, since they are able to change the government that has begun to lay down policies of good governance by beginning to dismantle the oligopolistic positions of the chaebols and increased transparencies in the financial sector, the economy has started to improve.

In all the above cases, it should be recognised that the overall economic situation has to improve, while in the meantime a great deal of political and economic difficulties have to be overcome.

The Indonesian crisis is the worst in the region and has become a regional problem because of the potential impact on regional stability and security. This is due to Indonesia's critical importance to ASEAN, her strategic importance to East Asia due to her leadership in ASEAN, the size of the country, the sea-lanes, and the serious spillovers to the region of her economic meltdown.

In economic terms she could trigger another round of devaluations, which also could have an effect on the Japanese economy, which is currently in such a vulnerably situation.

In conclusion it can be argued that regional economic security and stability will be influenced by the East Asian economic and political crisis because of the high degree of economic integration in the region, economically and strategically.

Good governance will have a real influence on the economic and political developments of the region. Good governance is therefore a factor that is going to influence stability in the region.

The Future Agenda

The East Asian miracle is no miracle. It is based on a lot of sweat, tears and blood of East Asians to make it possible for pragmatic, open and market oriented policies to be adopted. China has had the great

leap forward and the cultural revolution, Indonesia the traumatic change of government in 1965, Vietnam the costly invasion of Cambodia, Malaysia the riots of 1967, Philippines the dramatic change of the Marcos regime, Thailand the student and middle class revolt of 1973, 1976 and 1990. Therefore, the East Asian resilience and political will to develop and modernise will prevail, also in this crisis situation. East Asia will learn from the crisis on how to put its own house in order, including good governance and political development. This time East Asia is going through a correction and a maturing process, individually and as a region. It was a mistake and a certain arrogance to think that East Asia could forever grow rapidly as in the last 25 years without any correction.

Although there has been a lack of significant productivity growth, for instance as has been concluded by Paul Krugman, this has not been the only and most important deficiency. Lack of good governance and political development have been the more important impediment. High cost, inefficiencies, deviations from and lacunae in good macroeconomic policies have resulted from the lack of good governance, which in turn has created rampant monopolistic practices, cronyism, nepotism and corruption. The economic crisis reinforces the need for political and democratic development. The growing middle class is a factor that will also push for greater participatory processes.

Therefore, East Asia has to formulate new strategies for development that should be inclusive, balanced and sustainable. It is not too premature to start a robust de-

batc on the new dcvelopment strategies of the future whilc trying to overcome the crisis. It is important to come up with a new consensus for the longer term. This will help prevent future crises.

It is important to adopt a strategy of dcvelopment that is more people oriented and comprehensive and not only oriented towards rapid growth. Inclusivncss will also provide a kind of social safety net for the small people not only by the market. This is related to the need for pcnsion law, health care and education plus training. There must be a greater balance between the free market system such as in the US and the over-regulated government driven economy in continental Europe. In this regard, Singapore's experiences and policies can become a useful model. The problem of social justice is a pcrcnnial problem and dcveloping nations have been espccially vulnerable to this bccause of the rapid and uneven dcvelopment. Furthermore, continuous structural economic reforms and the introduction of a sound competition policy are vital.

As has been stated above, political dcvelopment is a must as it is an economic and socio-political prerequisite. Good macro-economic policies cannot be established without good governance, which is very much a part of democratic processes. Socio-political pressures for political participation and the development of a democracy have become a *conditio sine qua non* for stability and social peace in any country, which has a growing middle class, a globalised economy, universal education and a rapid advances in information technology.

Again, stages of political dcvelopment are acceptable and important to be pursued in tandem with economic dcvelopment. Excuses for dclaying political dcvelopment cannot last long as it will come back with a vengeance and will greatly damage past economic achievements. This danger looms large in the Indonesian case because of political stagnation. To get the country back on track will require a lot of efforts and sacrifices.

Questions and problems of sustainable growth have only emerged in the region. They include problems of acid rain in the north due to China's increased coal consumption, and the haze problems in South East Asia due to forest fires in Indonesia and Malaysia. Both have demonstrated the big calamity they can cause if nothing is being done immediately. But there are more problems to be solved, namely the issue of management of natural resources, water supply, air, ocean and the sea, forestry etc., which could hamper future economic dcvelopment and political as well as regional security.

These are the new agenda for future strategies of dcvelopment in East Asia. Regional cooperation on these issues is another must because the region has become so interdependent in a many fields. Diversities in East Asia have a limiting impact on regionalism. But common challenges and the necessity to solve them together will push the region together and will make regionalism a *conditio sine qua non* for future growth and dcvelopments, stability and security. That is the best foundation for regionalism.

What Should Be Done About the Haze*

Simon S.C. Tay

Introduction: Why Do Anything?

THE fires and smoke haze experienced by South East Asian countries in 1997 and 1998 have been described by UN Environment Programme chief, Dr. Klaus Topfer, as one of the world's worst environmental disasters. There are clear and considerable impacts in the region on human health, the environment, natural resources and economic activity.

From the fires of 1997, estimates are that between 800,00 and 4.5 million hectares of forests and bush in the Indonesian islands of Sumatra and Kalimantan were burnt.¹ For the 1998 fires, as at end April, official Indonesia estimates were that 395,000 hectares of forest and ground cover were destroyed.

The economic damage for 1998 in log and timber damage alone, without environmental and health costs, were set at \$912 million.² The fires and haze have had considerable economic impacts. An early estimate for the 1997 fires is that Indonesia, Malaysia, and Singapore have in total lost some US\$1.4 billion in increased health care, and foregone receipts in tourism.³

There are also considerable impacts on global environmental concerns with bio-

²*Straits Times*, 22 Apr 1998, Forest Fires Cost \$1.6 billion. Figures, in Singapore Dollars, were based on a report by the Indonesia Environmental Impact and Management Agency.

³A study by the Economics and Environment Program of South East Asia (EEPSEA) and the Worldwide Fund for Nature (WWF) estimate that regional economies in total suffered over \$1.3 billion losses for health, tourism and airlines because of the fires in the 1997. The main loser was Indonesia itself with some \$1 billion. This was followed by Malaysia (\$310 million) and Singapore (\$62.5 million). These estimates do not include losses from forest and plantation product. Nor are global losses such as climate change gases and biodiversity included. Longer term health effects have also not been calculated. The estimate should therefore be seen as preliminary, likely to be on the lower side.

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¹Nigel Dudley, *The Year Caught Fire* (WWF, Gland, Switzerland) puts the figure at 2 million hectares as at October 1997. Latest estimates by the Centre for Remote Imaging, Sensing and Processing (CRISP) however put the figure at 4 million hectares, based on satellite heat images.

diversity⁴ and climate change⁵ that significantly affect international attempts to address these issues.

The fires have implications for regional and inter-regional politics too. The ability of ASEAN to react to the fires, or their inability to do so, will test the working relations between the member states and affect the grouping's credibility in the eyes of others. Given the global implications of the fires to biodiversity and global warming, the ability and commitment of the international community and of international institutions is also tested.

In short, there are reasons of human health, global and local environment, economics, and international credibility to act. Almost all now agree that something should be done about the fires and haze. What exactly we should do however is open to question. Our answers depend on how we answer three primary questions:

- (1) What are the causes of the problem?
- (2) What are the answers and remedies?

⁴Fires this year have ravaged the biodiversity rich Bukit Suharto area and Kutai National Park in Kalimantan. One third of Kutai has been burnt. Indonesia is estimated to have 10 per cent of all known plants in the world, one-eighth of all animals and one-sixth of all birds, reptiles and amphibians. It is considered one of twelve "mega-biodiversity" countries in the world. The effects of the fire have yet to be fully measured, but it is already apparent that flora and fauna, and eco-systems have suffered. The fires have razed protected areas and reserves in the East Kalimantan. Scientists already indicate that rare bird species and animals like the endangered Sumatran tiger and *orang utan* have been badly affected.

⁵One study estimates that fires in Indonesia could add one billion tonnes of CO₂ gases to global warming, surpassing emissions from all of Western Europe.

- (3) How do we conceive the appropriate role of nations and agencies outside Indonesia?

There are, as such, a matrix of different policy responses that arise from these three primary questions. For instance, we may believe that the cause is Indonesia's lack of capacity in addressing the issue, or we may diagnose cronyism and corruption. If we think capacity is the root problem, we may prescribe giving financial and technical assistance, and providing equipment. Yet, even if we see capacity and financial assistance as keys to a solution, we may still feel that it is not our duty to contribute substantially to finance and other forms of help. On the other hand, if we see cronyism and corruption as the problems, we might not grant monetary assistance, feeling that funds will be misspent. Instead, we may believe that sanctions and other "sticks" are the key to getting Indonesia to address the problem. Yet, even if that is what we believe, we may still, for bilateral relations, wish to have someone else -- international bodies such as IMF or a superpower like the USA -- take those measures and incur Indonesia's resentment.

Given the many different possibilities, this essay will focus first on our perspective on the nature of the problem and its causes. It will then turn to different actors and actions open to them. *First*, to Indonesia, where most of the fires have started.⁶ Then, to ASEAN at the regional level; at the international level; and at the level of citizens -- by NGOs, companies and indi-

⁶The main source of fires and haze, especially prior to 1998, when Brunei and East Malaysia were also affected.

vidual consumers. The essay briefly reviews efforts to date: what we have done. It also considers suggestions on what more should be done.

While there are many suggestions, the essay tries to recognize the context of ASEAN and emphasize what may be politically acceptable to Indonesia and other parties. It does not however accept the ASEAN way as a given, but tries to seek ways to evolve the modes of cooperation to seek a solution.

Of the many suggestions surveyed, the emphasis of this essay is to link economics and environment towards sustainable development. Such a linkage is controversial in an ASEAN context. The argument is, however, that there is no other means to bring sufficient priority and attention to the issue in Indonesia. Additionally, the essay will seek to centre the link between economics and the environment not on sanctions, but in more positive ways.

Perspectives: What Should We Seek To Do?

Our perspective on the nature of the problem shapes our response. Despite the grave effects on the local environment, human health, economic activity, lost resources and global environmental concerns, our perspectives are betrayed by the terms we use to describe the problem. The tendency in the region is to talk about the "haze", rather than "pollution". The use of the term, "haze", understates the risk to human health.⁷

⁷Scientists suggest that emissions from forest fires have a far greater potential for long term and

The perception of "haze", also contrasts to a focus on the fires that cause it. The term "haze" suggests that, if winds change direction, there is no problem for West Malaysia or Singapore. This may help explain the inaction among the ASEAN governments after the 1991 and 1994 incidents of haze, despite the 1995 ASEAN Cooperation Plan on Transboundary Pollution. Changing our perception to focus on the cause -- the fires -- might help sustain action in the medium to longer term, even when our cities and towns are not smogged in. Focusing on the fires helps us think preventively.

Our perceptions should also be challenged in viewing this as a regional or sub-regional problem, entangling only ASEAN or the sub-group of Brunei, Indonesia, Malaysia and Singapore. Rather, we need to see that are impacts on biodiversity and on climate change, both global environmental issues, as agreed by the vast number of states that have signed onto the UNCED treaties on these subjects. This legitimates concern among nations far beyond the region.

In looking at the use of fires, we must bear in mind the clear satellite evidence in 1997 that most fires were started on large land-holdings and plantations. These are run by large conglomerates, many with international and regional investors. The main source of the fires, as the Indonesian government itself stated, is not small scale indigenous farmers.⁸ These large businesses

serious human health concerns than normal city pollution.

⁸Some have suggested that main causes of the fires are land clearing by small-scale indigenous farmers, using traditional slash-and-burn methods of

have continued to use fires for land clearing not because of tradition but because it is a cheaper alternative to other, less pollutive methods. This is despite Indonesian laws that prohibit the use of fire.

In discussing the fires and haze, some perspectives have emphasized the El Nino climatic effect. Such a perspective can easily lead to fatalism: that we should do nothing but wait for the weather to change. It must be noted however that there have been fires and haze occurrences in years when there was no El Nino and, conversely, there have been previous El Nino phenomenon which did not coincide with the fires.

Others have taken the perspective that the current political and economic uncertainties faced by Indonesia exacerbate the problems. This perspective is useful in emphasizing the realism of the current situation. It should not however be turned into a blanket excuse for inaction. It must be recognized that the fires and severe haze also occurred in 1994 and the early 1980s, years when Indonesia was stable and flourishing. Present economic-political uncertainties may lessen our ability to respond effectively

to the problem, but are not their root.

Given the focus on fires, it may seem that fire-fighting is the key response. Some emphasize the use of high-tech fire-fighting, moreover, with fire-bombing from airplanes or helicopters. Clearly, when fire has broken out, fire-fighting is needed, especially timely and quick fire-fighting, backed with well trained and equipped fire fighting units on the ground. But fire-fighting should not be our only response. Rather, the fires need to be addressed in the medium to longer term, to prevent the recurrence that the past years have witnessed, in both El Nino cycles and at other times. Taking a medium to longer term perspective emphasizes prevention, rather than emergency response. What we should do then goes beyond the immediate task of fire-fighting to look at education and other methods to prevent, limit or control the use of fire in clearing land. Management and strategy are needed. In contrast, fire-fighting will always be just that: fire-fighting.

The following table (Table 1) summarizes the keywords for our perspective to take action on the South East Fires, in contrast to misperceptions that foster inertia, misdirected attempts or palliative efforts:

Once we take the perspective for action, the first and primary cause of the fires also becomes clear. It is the failure of the Indonesian system to enforce its own laws and regulations, and to manage its resources so as to pursue sustainable development. The attempts by Indonesia to deal with the fires, or the lack of such attempts, must first be examined before we look to regional and other responses.

farming. Indonesian officials have also claimed that the El Nino weather phenomena is to blame. Clearly these are contributing factors, especially the latter. Indonesia reports however admitted that some 80 per cent of the forest fires in 1997 are attributable to land clearing by large plantation owners. Satellite images have pin-pointed land clearing by fire on oil palm plantations and on timber concessions, after the valuable timber has been extracted. Some 180 companies were named as being involved in 1997, of which five have only recently begun to face prosecution by Indonesian governmental agencies. *The Straits Times*, 25 April 1998, "5 Firms to be sued over fires".

Table 1

PERSPECTIVES: WHAT SHOULD WE SEEK TO DO?

Perspective for Action	Misperceptions for Inertia
Fires, pollution	Haze
Local, regional and global effects	Local effects only; Indonesia's concern
Recurrent	El Nino fluke
Primarily from large businesses	Traditional small-scale farmers
Response weakened by poverty and problems in Indonesia	Problem caused by poverty and problems in Indonesia
Prevention, control, integrated forest management and fire-fighting	Fire-fighting
Unsustainable development	Lack of development

What Indonesia Has and Has Not Done To Date

Given the largely man-made beginnings of the fires, and their primary location within one nation -- Indonesia -- national legislation and policy-making might be expected to be sufficient to prevent and control the environmental problem.⁹ This is particularly because the greatest human, environmental and economic damage is suffered by Indonesia and its nationals.

Yet national responses have been ineffective. As noted, this is due in part to the fact that Indonesia currently face not only the environmental disaster of the fires, but also the economic downturn and uncertainty in its once booming economy. With its economic problems,¹⁰ there are doubts that Indonesia presently has the financial

wherewithal to stop the problem, even if the political will exists.¹¹ It is clear, and understandable, that Indonesia is giving priority to its economic crisis, the resultant political tensions and an increasing famine in some areas, resulting from both crop failure and the sharp depreciation of their currency.¹² Even before the recent political crisis, the then environment minister for Indonesia admitted the fires were at most fifth on the national agenda.

While not a priority, some environmental efforts have been made. The use of fire to clear land has been illegal under Indonesian law since 1993. Penalties for the use of fire to clear law were increased in 1997 to

⁹Only in 1998 were fires located in E. Malaysia and Brunei.

¹⁰Indonesia's economic problems has come to international concern, drawing in the International Monetary Fund and the involvement of G-7 countries, such as the USA.

¹¹These problems have been admitted by the then Indonesian Environment Minister, Sarwono Kusumaatmadja, as well as his successor after the 1998 elections, Juwono Sudarsono. See "Crisis hampering fire-fighting", *The Straits Times*, 21 February 1998.

¹²The UN World Food Programme launched an appeal for \$88 million in emergency aid to help Indonesia meet food shortfalls. See "\$138 million food aid sought for Indonesia", *The Straits Times*, 25 April 1998.

a maximum of 15 years' jail and a maximum fine of 250 million rupiahs.¹³ New laws also allow the government to seize the assets and close down the activities of companies found guilty. The critical failure in Indonesia is not that laws are missing, but that laws have not been effectively enforced.

The names of some 180 major companies thought to be involved were released in 1997. None, however, have been successfully prosecuted to date and only five have recently begun to face prosecution by Indonesian governmental agencies.¹⁴

The lack of effective enforcement is systemic. The Indonesian Ministry for the Environment does not have direct jurisdiction over the agricultural and forestry lands involved. Nor can it command provincial authorities to enforce the laws. Many observers blame the failure of enforcement on institutional weakness, corruption and cronyism; much like the economic problems. Reform of the legal and administrative system is the advice.

There are additional and differing analyses. Some commentators emphasize the lack of capacity in Indonesia. They argue that even assuming that there is political will to address the environmental issues, there is a lack of capacity in fire-fighting and other relevant institutions, especially at the provincial level.¹⁵ Their response would be to increase assistance to Indonesia, in

terms of funding, equipment and technical assistance, both for fire-fighting.

Others believe that problems stem from misguided development policies and inappropriate land use, often with short or uncertain land tenure. These cause a higher rate of conversion of land from forest to plantation (with the use of fire); irrational allocation of lands for conversion, by which virgin forest is converted and not degraded forest or *alang-alang* (wild grass) lands; and the lack of any incentive of companies to adopt sustainable practices in forestry, such as re-planting. Different suggestions arise from this identification of these problems.

Some would urge us to stop the conversion of virgin forest land to plantation land, and to conserve those lands for nature. Some conservationists urge this perspective. Many from developing countries would however view this as another disguised constraint on economic development, in contradiction of the right to permanent sovereignty over natural resources, the right to development and the principles of sustainable development.¹⁶

Other forestry experts do not emphasize conservation per se, but that a priority be established for land conversion. By such

¹³Approximately \$40,000

¹⁴*The Straits Times*, 25 April 1998, "5 Firms to be sued over fires".

¹⁵This is, for example, the underlying analysis of the UN team that surveyed the problems in Kalimantan, leading them to call for some US\$10 million in assistance for fire-fighting staff and equipment.

¹⁶The prohibition of any development to the forest and lands would, arguably, run counter to the idea of sustainable development. This is the concept of a balance between environmental conservation and economic development that was the central theme to the UN Conference on Environment and Development, and the earlier Brundtland Report. The term lacks precision in practice. But the tenets of sustainable development point us to the idea that development of such lands is permissible, provided that its negative effects are ameliorated. Chief of these ill-effects would be the use of fires that cause the haze pollution.

priority, degraded forest and *alang-alang* fields in Kalimantan would first be converted to plantation land, rather than virgin forest and peat bog swamps. Such a recommendation would seem to allow the development of plantations while avoiding the greater harm to rainforests, striking a better balance for sustainable development. This has been the thrust of several programmes in Indonesia by agencies such as the International Tropical Timber Organization and the German GTZ agency. It remains to be seen if the Indonesian government will consider and commit to such reforms.

What, in sum, Indonesia has failed to do is: (1) to ensure compliance with its own existing laws; (2) develop sufficient capacity to deal with the fires; and (3) shape and change land use and other policies for sustainable development.

The following steps would assist Indonesian in responding more effectively to the fires:

1. Agencies must be activated to enforce their own laws and regulations. These agencies must necessarily go beyond the Ministry of Environment, to involve and coordinate between agencies with appropriate jurisdiction and reach, such as the Ministries of Agriculture and Forestry, the BAPEDAL agency and provincial authorities.
2. Enforcement of the laws must be equal and even, extending to companies involved in cronyism and corruption, as well as those with foreign investments.
3. As regards land use, the tenure of land concessions and ambiguous property rights in Indonesia may also have to be considered.

4. Without preventing the sustainable development by Indonesia, the rational use of land should be encouraged. In particular, oil, palm and other plantations might be developed not in virgin rainforest, but rather in degraded forest or *alang-alang* (wild grass) fields. This would require initial efforts and inputs but conserve the ecological and other values of the rainforests.¹⁷

The first and best remedy to the fires clearly lies within Indonesia itself. There are however reasons to look beyond Indonesia's efforts at the national level. International and regional organizations and communities can assist and support Indonesia's efforts. This may be a necessity to supply Indonesia's lack of capacity. There may also be a need for international and regional efforts to supplement or over-ride the national efforts, if we take the reason for Indonesia's failure to date to be systemic cronyism and corruption.

What should Be Done By Those Outside?

What should we do, from outside Indonesia? Much depends our view on the appropriate role of ASEAN, the international community and the private sector.

Some in Indonesia and ASEAN believe that nothing should be done by those out-

¹⁷International assistance could of course be sought to compensate for the additional cost of prioritizing degraded land for development. For conservation areas, such as rainforests and peat bog swamps, a range of techniques may be considered to allow the international community to bear part of the costs of conservation e.g. debt for nature swaps, bio-prospecting agreements.

side the nation, as this would constitute a breach of the norm of non-intervention. This is a key tenet of the ASEAN way.¹⁸ In this view, the fires are the internal affair of Indonesia, over which no state or ASEAN itself can legitimately take action.

Such a conception of the ASEAN way is misconceived. First and foremost, the haze is not a purely internal matter for Indonesia. There are clear and severe external, transboundary effects and damage. This transboundary character removes it from the realm of exclusive jurisdiction. The effect of the fires on global issues of biodiversity and climate change have similar effect.

A second and connected reason is international law holds that a state is responsible for transboundary harm that results from activities on its territory, carried out by the state or within its control. This, arguably, stems from the general international law of state responsibility¹⁹ and the landmark Trail Smelter arbitration,²⁰ and is enshrined as Principle 21 of the 1972 Stockholm Convention on the Human Environment.²¹

¹⁸ Anatolik.

¹⁹ Corfu Channel (UK v Albania) 1949 ICJ 4.

²⁰ USA v Canada (1941) 3 UN R.I.A.A 1938 (1949). The Trail Smelter Arbitration between Canada and the USA may be seen as a precedent for its ruling that "no state has the right to use or permit the use of its territory in such a manner as to cause injury by fumes in or to the territory of another (state)". The arbitral panel awarded monetary damages in favour of the USA. It also acted preventively, ordering the Trail Smelter "to refrain from causing any damage".

²¹ Principle 21 of the Stockholm Declaration is said many environmentalists to represent customary international law. The principle recognizes the sovereignty of states but balances this with their

Based on this principle, Indonesia should be held responsible to the affected countries for the consequences of its failure to enforce its own laws and to control the fires.²² There have also been suggestions that ancillary or procedural duties arise. Such duties require states to generally prevent, mitigate, repair for harm and notify others of risks. These principles of state responsibility and liability for transboundary harm clearly limit the norm of non-intervention.²³

responsibility to "ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction". Following Principle 21, leading bodies of international lawyers, such as the Institut de droit international, have adopted resolutions or other statements that assert State obligations on transboundary pollution. Principle 21 may seem to be "hard" law, reassuring to some lawyers amidst the declarations of "soft" law and emerging principles that characterize so much of the environmental arena. Moves which may dilute the legal characteristics of Principle 21 are accordingly criticized. For example, its reiteration in Principle 2 of the Rio Declaration has been said to be "a skilfully masked step backwards" (Marc Pallemarts, *International Environmental Law From Stockholm to Rio: Back to the Future?*, in *Greening International Law* (Sands, editor) 1994. This is because Principle 2, while recognizing state responsibility, also declares that "states have ... the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies" (italics added).

²² This would arguably be so even if the actions causing the haze may be traced to private companies in distant areas, over which the government in Jakarta may have little effective control.

²³ It is true of course that the fires take place on sovereign soil. If their transboundary effect could be controlled, then Indonesia would be free to use fires. If that is however not possible, then the fires -- as much as the haze they cause -- are of legitimate regional and global concern. In contrast, while land use in Indonesia may contribute or indeed be the root cause of the fires and haze, Indonesia's land use policies may be considered an internal matter.

There are difficulties in applying Principle 21 and the Trail Smelter case. Establishing legal responsibility would be difficult given the lack of a threshold for transboundary pollution in terms of the haze, established by either custom or treaty.²⁴ In the ASEAN context, it is very unlikely that any state is likely to try to impose state responsibility on Indonesia, in a strict, legal meaning and hold it liable to harm. Although intra-ASEAN disputes have recently been referred to the International Court of Justice for peaceful settlement of disputes, a litigious attitude over the fires might be seen to be antithetical to the ASEAN way. It may also be unrealistic, given the limits of Indonesian capacity to respond.

To date, the Indonesian government has accepted moral but not legal responsibility, with then President Soeharto offering a public apology at an ASEAN environment ministers meeting in 1997. The governments of Singapore and Malaysia, the two most affected neighbours, have not to date publicly complained to Indonesia, claimed any legal right against Indonesia or pursued any legal approaches to seek compensation.²⁵ But recognizing the norm of state responsibility is a strong basis to suggest that Indonesia has a duty to consult and cooperate with affected states, and take good

faith measures within its capacity to further agreed actions.

The principle of agreement is a third factor that must be noted. Where Indonesia consents to action plans, offers of assistance and other cooperative measures, there is no interference in Indonesia's domestic affairs.

What Has Been Done To Date?

ASEAN Responses

ASEAN has not been inactive on the issue of the fires specifically, or on the environment, more generally. Its record has, however, been mixed. ASEAN countries have often come under criticism from environmentalists and NGOs. This is especially in respect of tropical deforestation and the lack of conservation efforts. To date many countries in the region have been impacted by industrialization one hand, and the continuing problems of poverty and the lack of infrastructure on the other hand.²⁶

As a grouping, ASEAN took its step forward on the environment in 1978. Its first Ministerial level declaration on cooperation on environmental issues followed in 1981.²⁷ It has however been better known taking a pro-developing country stand at the 1992 Earth Summit.²⁸ ASEAN countries also rallied

This is because land use and conversion may be achieved without the use of fire or causing haze.

²⁴For a critical overview of the principle of state responsibility for transboundary pollution, see Oscar Schachter, *International Law in Theory and Practice, Chapter XVI: Protecting the Environment*, at pp. 362-387.

²⁵The same was notably the case among neighbouring states in the aftermath of the Chernobyl and Sandoz disasters in Europe in the mid 1980s.

²⁶1990 and 1995 Reports on the State of the Environment in the Environment in the Asia-Pacific, UN ESCAP.

²⁷For a compilation of ASEAN documents, see Selected ASEAN Documents on the Environment (compiled by KL Koh), APCEL Document Series, 1996.

²⁸Singapore Resolution on Environment and Development and Common Stand on UNCED, Singapore 18 February 1992.

to lobby successfully against Austrian eco-labels on tropical timber.²⁹ Most recently, ASEAN countries have been central to the challenge in the World Trade Organization against US laws against shrimp imports, where production methods do not safeguard against the killing of sea turtles.³⁰

More positively, ASEAN members have undertaken some steps towards improving environmental cooperation amongst themselves, and with other states. These have taken the form of environmental programmes, evolving through three phases to an ASEAN Strategic Plan of Action (1994-1998).³¹ The strategies cover a broad range of environmental concern and adopt many of the approaches recommended in Agenda 21.³²

The effectiveness of such measures however suffer from weakness in monitoring,

²⁹For a description and analysis of the Austrian trade measures on tropical timber, the ASEAN reaction and the likely outcome in light of GATT rules, see Brian Chase, *Tropical forests and Trade Policy: The Legality of Unilateral Attempts to promote Sustainable Development under the GATT*, *Hastings International and Comparative Law Review*, 1994, Vol. 17, p. 349, especially at pp. 374-379.

³⁰GATT panel final decision 6 April 1998.

³¹ASEAN Strategic Plan of Action on the Environment, Jakarta, 1994.

³²Broadly, the ASEAN strategy seeks to integrate environment and developmental concerns in the decision making process of governments through such mechanisms. Other needs recognized by the Strategy Plan are to foster government and private sector interactions; strengthen institutional and legal capacities; to establish a regional framework on biological diversity conservation and sustainable use; to promote the protection of coastal zones and marine resources; and to promote environmentally sound management of toxic chemicals and hazardous wastes and a system for promoting environmentally sound technologies.

assisting and ensuring state compliance. This is in view of the "ASEAN way" and its preference for non-interference in the domestic affairs of member states; for non-binding plans, instead of treaties;³³ and for central institutions with relatively little initiative and resources. As such, the ASEAN environmental undertakings may be characterized as plans for cooperation between national institutions, rather than the creation or strengthening of any regional institutions as a central hub for policy-making or implementation. These same characteristics of the ASEAN way find expression in the specific agreements on the fires and resulting haze.

ASEAN environment ministers agreed to a Cooperation Plan on Transboundary Pollution in June 1995.³⁴ The Cooperation Plan set out the broad policies and strategies to deal with atmospheric and other forms of transboundary pollution. This followed the haze in 1994. The Cooperation Plan outlined efforts to be made at both national and regional levels to deal with the

³³The one treaty that was negotiated among ASEAN members, the Agreement on the Conservation and Natural Resources, has not been ratified by a sufficient number of member and, as such, is not in force. The Agreement was signed by all six ASEAN members at that time, in Kuala Lumpur, Malaysia on 9 July 1985. Only three countries have however ratified the agreement, one less than required to bring it into force.

³⁴The introduction of the ASEAN Cooperation Plan traces its development to ASEAN resolutions, meetings and strategic plans on transboundary pollution starting from 1990. Notably, immediately prior to the adoption of the ASEAN Plan, the Informal Ministerial Meeting on the Environment held in Kuching, Malaysia on 21 October 1994 recognized the need to control transboundary pollution within the region by treating it as "one ecosystem".

haze. At the national level, each country undertook to establish focal points and enhance national capabilities to deal with forest fires. Countries also agreed to share knowledge and technology on the prevention and mitigation of forest fires, and establish a mechanism for cooperation in combating forest fires.

A common air quality index and a regional fire danger rating system was to be developed for the region. ASEAN institutions like the Specialized Meteorological Centre were tasked to develop ways of predicting the tracts spread of smoke haze.

The Cooperation Plan also envisaged seeking support from countries outside the region, from countries with knowledge in fire management systems, like New Zealand and the USA, as well as institutions such as the International Tropical Timber Organization, based in Japan.

The Cooperation Plan is not as formal as comparable treaties in other regions, like Europe, which deal with long distance trans-boundary harm. Its principles and approach, however, might seem workable and indeed commendable. First and foremost, perhaps, the Cooperation Plan recognized that the region was a single eco-system. Additionally, it emphasized the need to build on both national and regional efforts so that one complements the other, and incorporated principles of prevention and of mutual assistance and cooperation. It also recognized that while all states have a common interest in reducing or avoiding a recurrence of the haze, they have different abilities and responsibilities in working towards a solution. In this respect, the Cooperation Plan gives expression to the principle of common

and differentiated responsibility, recognized in the Rio Declaration, at a regional level.

But the failure of the Cooperation Plan has been in its implementation. Very few steps envisaged were actually taken. The outbreak of fires in 1997 showed up the lack of follow up to the Cooperation Plan in almost all areas. Singapore's assistance to Indonesia by providing satellite imaging of fires and "hot spots" was the exception that proves the rule. Instead of working within an agreed system of cooperation, countries were left to bilateral arrangements and emergency discussions -- especially between Indonesia and Malaysia, and Indonesia and Singapore. The international assistance that was given in 1997, mainly for fire-fighting, was largely piecemeal and uncoordinated.

Following the 1997 fires, the ASEAN environment ministers agreed in December 1997 to a further Regional Haze Action Plan to provide further commitments and detail.³⁵ Again, the objectives of the Action Plan are commendable: to prevent land and forest fires; to establish operational mechanisms to monitor fires; and to strengthen regional fire-fighting capabilities. The Action Plan reiterates the need for regional monitoring and to identify sources of technical assistance within and outside ASEAN, from other countries and from international organizations such as the Asian Development Bank and United Nations Environment Programme. The primary emphasis of the Action Plan continues to be on national plans and capabilities. However, the Action Plan agreed

³⁵ASEAN Ministerial Meeting on Haze, 22-23 December 1997, Singapore.

to establish a procedure by which fire-fighting resources could be pooled for regional fire-fighting operations.

Upon review in April 1998, the Action Plan agreed to establish two Sub-regional Fire-fighting Arrangement for Kalimantan and for the Sumatra/Riau provinces in Indonesia.³⁶ Indonesia also announced that it would lay down the framework for an ASEAN Research and Training Centre for Land and Forest Fire Management in Central Kalimantan.³⁷ Further details and arrangements under the Action Plan may be expected between ASEAN member states.

Clearly, the Action Plan is a welcome attempt to kick-start the stalled work of the earlier and more general Cooperation Plan. Doubt however remains on the ability of ASEAN as an organization to supply the omissions of the Indonesian national system. This is primarily because of the ASEAN norm for non-intervention in the domestic affairs of member states and the dominant role that Indonesia plays in the grouping. The relative weakness of central institutions in ASEAN is another major factor.

In the face of these obstacles, ASEAN has to date been unable to supplement failures by Indonesia to address the South East Asian fires. There have instead been recent attempts by ASEAN to internationalize the issue. Can international institutions and principles suffice?

International Institutions

In March 1998, the Asian Development Bank committed itself to provide regional technical assistance in management policy and enforcement, monitoring mechanisms and enhancing fire-fighting capabilities. ASEAN also agreed that UNEP should play the lead role in coordinating international assistance to combat and control the regional fires.³⁸

This takes a step forward towards finding solutions to the fires at the international level. This seems to be the only possibility left, given the failures at the national and regional levels. But while there may be no other alternative, it still remains to be seen if international institutions and principles of international law strong enough to deal effectively with the fires and the issues that arise.

Institutionally, the key international organization that has responded to the fires is UNEP.³⁹ Understandably, UNEP is giving priority to fire-fighting, taking a key role in the UN Disaster Assessment and Coordination Team that assessed the impact of the Kalimantan fires⁴⁰ and convening an international meeting of donors.⁴¹ In re-

³⁸ UNEP Executive Director, Klaus Topfer had earlier called for international attention to the fires but not sought the role of coordinating assistance. See *Asiaweek*, 13 March 1998, p. 48, for interview with Topfer.

³⁹ The World Health Organization has responded with a programme dealing with the human health risks. The UN Food Programme has begun a programme to deal with the famine to which the fire and drought have contributed.

⁴⁰ UNDAC Mission Report March-April 1998: Indonesia: Land, Bush and Forest Fires [DPR 213/3 (7-6)] Indo '98.

⁴¹ Held in Geneva on 21-22 April 1998.

³⁶ Joint Press Statement, Third ASEAN Ministerial Meeting on Haze, 4 April 1998, Brunei, para. 8.

³⁷ *Ibid.*, para. 5.

sponse to the fires, international assistance has come from a large number of countries⁴² and agencies.⁴³ Some of the assistance has been in terms of fire-fighting equipment.⁴⁴ Australia and the USA have also provided assistance in terms of waterbombing.

Such assistance has had some palliative effect but clearly did not engender a stable situation to prevent the recurrence of fires in 1998. Fire-fighting by means of waterbombing, in particular, would seem a spectacular but expensive waste of money and scarce water in drought-stricken areas, unless supported by sufficient efforts on the ground.

The present challenge of international assistance is therefore to go beyond fire-fighting to find and implement strategies of prevention and control at the national level. It remains to be seen whether the international community and relevant international organizations can do this effectively.

In the international community as with ASEAN, no state has sought to hold Indonesia responsible for the fires and haze, and their global consequences. Instead, the approach of ASEAN's plans, as already noted, and now of international donors has been to emphasize cooperation with Indonesia. This may fit the realities of the South East

Asian fires. But it makes for unfavourable principles to govern the international community.

At best, the arrangements of the international community and of ASEAN may be said to reinforce an idea akin to the principle of common and differentiated responsibilities; that if all have an interest in putting a stop to the fires of South East Asia, then the regional and international communities must render assistance to Indonesia. Arguably, Indonesia has a reciprocal duty to cooperate and make good faith efforts to take steps agreed with other states.

Given the current attention to fire-fighting and to improving indigenous fire-fighting capability in Indonesia and among its neighbours, it may be understandable that principles of international environmental law may be de-emphasized. But what has been done may not be sufficient to meet the problem of the fires. What else can and should be done?

What More Should Be Done?

In moving ahead, assistance will have to go beyond fire-fighting to deal with the causes of the fires and to set up system of prevention and control. One approach would be to increase the capacity of the relevant Indonesian agencies. A second approach is to strengthen the systems of international cooperation, especially in ASEAN. The third, and perhaps key approach, is to ensure that the issue receives sufficient priority, and stimulate the internal reform of Indonesia's system to achieve that end.

The first approach, of increasing capacity, largely looks to the provision of in-

⁴² Australia, Canada, China, Denmark Finland, France, Germany, Japan, Malaysia, New Zealand, Norway Russia, Singapore, South Korea, Swede, Switzerland, Thailand, United Kingdom and the USA.

⁴³ These included: UNDP, UNEP, UNICEF, UNESCO, WHO, CIDA, GTZ (German-Indonesia Development Cooperation), USAID, ADB, ASEAN, WWF, IUCN, OPEC and the World Bank.

⁴⁴ See "Donations of fire-fighting gear for Jakarta", *The Straits Times*, 21 February 1998.

centives or "carrots" for Indonesia. The second approach is largely functional, seeking to improve the regimes of cooperation. The third, of increasing the priority that Indonesia gives to the issues, can include a variety of measures of enforcement or "sticks". They may therefore be controversial.

ASEAN

At the regional level, ASEAN may have to reconsider and adapt the "ASEAN way" if it is to be relevant and effective in situations of transboundary harm.⁴⁵ Non-interference cannot be maintained as an icon in the face of ecological disaster that knows no border. A regional treaty setting thresholds for transboundary harm and creating sufficiently strong institutions to monitor and assist their compliance would be a step towards guarding themselves against future fires.

Suggestions for improvements in ASEAN can be discussed in two clusters: (i) more specifically, on options in treaty-making for transboundary pollution; and (ii) more generally, on reconciling ASEAN norms and strengthening institutions.

Treaty-Making for Transboundary Pollution

As noted earlier, the ASEAN plans may be characterized as cooperative approaches rather than attempt to create liability regimes or set specific environmental limits. Since these latter types of treaties have had

more success in dealing with transboundary pollution, steps might be taken to evolve the ASEAN Plans towards one or the other type of treaty. Liability regimes are relatively few and far between. In the ASEAN context, it seems unlikely to be politically acceptable. If, however, that would be the intention, a number of proposals might be made to make it more acceptable.

The first is that more types of transboundary pollution should be covered, and not just the atmospheric pollution and, even more specifically, the haze. Focusing on the haze alone would give Indonesia very few reasons to agree or, even if they agree, to comply with any such regime. The approach to any liability regime should be to place equal emphasis to seaborne pollution, especially in the Straits of Malacca, and the shipment of hazardous waste.⁴⁶ Given that Singapore and, to a lesser extent, Malaysia have been criticized for these forms of transboundary pollution, because of their heavier involvement with trade and shipping, this might create a greater balance of interests for Indonesia and a more reciprocal system between the states.

The second suggestion is that any system of liability should be devolved from the state level to the level of private actors. This would allow citizens of the states to invoke proceedings in the courts of another state. The target could be, instead of the government of that state, any private corporation involved. This would follow, in part, the example of the Nordic treaty. This would lessen the possibility of political embarrassment and intergovernmental

⁴⁵ ASEAN has concluded the South East Asian Nuclear Weapons Free Zone Treaty which allows for interstate reporting, monitoring and inspections. See Article 14 of the Treaty.

⁴⁶ Covered by the Basel Convention or otherwise.

confrontation, which are antithetical to the ASEAN way.

Another direction would be to evolve the ASEAN Plans towards setting specific targets for atmospheric pollution fires and haze. This might well be difficult, given different environmental priorities, stage of industrial development and administrative and technical capacity between countries. There are even different measurement systems in ASEAN for air borne pollutants. Harmonizing limits, such as seen in the European Community experience,⁴⁷ in such a situation might not be achievable.

If a common system cannot be achieved, an alternative would be to hold states to set their own national laws and limits and then to hold them to it, through an inter-governmental panel. This is an approach seen in a number of agreements on trans-boundary pollution.⁴⁸ It is less difficult than reaching common limits, agreed by all. It also avoids the imposition by any one country of its own unilateral standards. Instead, like the Golden Rule, each coun-

try is held to do to others what it would do domestically for itself.⁴⁹

In the immediate to medium terms, some may believe that ASEAN Plans must remain, essentially, agreements for cooperative, national behaviour. Even as such, they may still be strengthened. One measure is to have regular and more open review of national plans and implementation. The ASEAN Action Plan as implemented in early 1998 improves on the 1994 Cooperation Plan by having a regular review by Ministers and, more regularly, by officials. Holding such reviews is the most common mechanism for encouraging state compliance.

There are however differences between modes of review. For example, who participate in the review? On one hand, review could be internalized and limited to officials, as it is in the ASEAN Action Plan. At the end of the range of possibilities, there might be a more open review, with the involvement of recognized NGOs with expertise and interest. At an interim position, review might be open to relevant Inter-Governmental Organizations, such as the secretariats for the UN Convention on Biological Diversity and for the Climate Change Convention; both global issues which are connected to the SE Asian fires and haze.

Alternatively, the ASEAN Secretariat itself might serve a role in commenting at reviews, from a more impartial point of view. Such a role for the ASEAN Secretariat would, however, require that the organization be strengthened in knowledge and capacity, and have the legitimized role of

⁴⁷See Air Pollution Control in the European Community Implementation of the EC Directives in the Twelve Member States (Graham Bennet, ed.) 1992. For an overview of the harmonization techniques within the EC, see Damien Gerardin, *The European Experience*, in *Asian Dragons & Green Trade* (Tay and Esty, eds.) 1996.

⁴⁸The North American Free Trade Agreement (NAFTA) between Canada, Mexico and the USA takes a similar approach, thereby avoiding the need to harmonize limits. The OECD Council Recommendations on Principles Concerning Transfrontier Pollution uses a "principle of non-discrimination" by which states control their transboundary pollution to the same standards as applicable to similar pollution within their borders, and allow private plaintiffs access to their courts for redress, no matter where the damage is suffered.

⁴⁹See Merrill, *Golden Rules*, *infra*, from p. 997.

providing such review. This brings the essay to consider the second cluster of possible improvements: reconciling ASEAN norms and strengthening institutions.

Reconciling Norms and Strengthening Institutions

It must be recognized that the ASEAN norm against non-interference does not preclude lawful actions as regards transboundary pollution. By its very nature, transboundary pollution is not a purely domestic affair. Steps in this direction have already been taken by ASEAN by recognizing the issue and promising cooperative actions. The further step that needs to be taken is for the pooling and mobilization of joint resources, such as fire-fighting units. This again has been promised by ASEAN and bilateral agreements. It appears however that there continues to be considerable implementation problems and obstacles on the ground, arising from political sensitivities. There is no immediate solution.

In the medium to longer term, however, confidence building measures might be suggested to assist. Joint exercises between fire-fighting units and other involved agencies in ASEAN member states would assist. For a start, if Indonesia sensitivities remain, perhaps these exercises might be conducted initially on East Malaysian or Bruneian territory, or even further afield, in ASEAN member states like Thailand and the Philippines. The latter countries are not so primarily affected by the present fires but have comparable experiences in forestry and the control of forest fires. The participation or even leadership of neutral

agencies, such as UNEP and ASEAN, might also assist in defusing sensitivities.

Second, there must be a mutual recognition of the human, economic and other costs of the fires and haze. This follows from the precept that the seriousness of the harm increases the prospect of finding co-operation and, conversely, the relative insignificance of the problem lowers those prospects.

At present, many of the cost estimates have come from NGOs and think-tanks. ASEAN governments will need to take these estimates into their official consideration or to generate figures of their account. This may assist the Indonesian political system in recognizing the real costs to their own people and economic system. It would also be a basis for affected states to make the economic commitment to fund the necessary steps for the prevention and control of future fires. This has not been done to date.

Perhaps for this reason, despite NGO estimates of losses running into hundreds of millions, neither Malaysia nor Singapore have been forthcoming on the suggestion for a multilateral revolving fund or, to some degree, to assist in UNEP's request for \$10 million for interim fire-fighting measures.⁵⁰

It is common sense that cooperation will only succeed if, for all parties, the benefits are greater than the costs.⁵¹ Part of the response to this reality must then be to fully recognize the benefits to be gained by controlling transboundary pollution.

⁵⁰The concern of the states involved, of course, might legitimately be on the effectiveness of the proposed actions.

⁵¹See Merrill, *infra*, at p. 988.

Third, ASEAN's general capacity for environmental policy-making will need to be strengthened. As noted, ASEAN's institutional capacity has been limited because the ASEAN way doubts the effectiveness of supranational institutions. Within ASEAN too, environment has not been emphasized. This way have to be addressed in dealing with transboundary pollution, as much as national capacities. ASEAN should have sufficient resources and knowledgeable personnel to add value to national efforts to deal with the transboundary pollution. This might assist and help smooth matters if and when bilateral discussions become ruffled. The use of good offices of the ASEAN Secretary-General might also be strengthened.

Fourth, the possibility of linking environmental and economic concerns within ASEAN should be considered. It is clear that initiatives such as the SIJORI Growth Triangle, between Singapore, southern Malaysian states, and the Riau Islands and Sumatra provinces of Indonesia, thicken economic interdependence, as do ASEAN-wide programmes, such as the ASEAN Free Trade Agreement and ASEAN Investment Agreement. It is also discernible that environmental standards have an economic impact on traders and, especially, investors. Higher standards might exact higher costs for business and, therefore, to attract investment, countries may lower or be loathe to increase environmental protections.⁵² There is there-

fore economic sense to connect ASEAN's economic agenda to its environmental concerns. Conversely, linking the environment to economics would help prioritize the former. On the whole, such connections would help ASEAN countries take steps towards sustainable development, reconciling environment and economics.⁵³ A first step in this direction would be to call for a sustainable development forum at which both economic and environment ministers for each country would attend.

International Community

At the international level, environmental policy-making must continue to strengthen both institutions and principles.

As regards institutions, the role of UNEP in responding to the fires in 1998 has not been fully played out. With so many bilateral donors and the efforts of other UN-related or other agencies involved, UNEP may face considerable difficulties in effectively coordinating the efforts. What happens in South East Asia, in this sense, may have wider implications on UNEP's perceived effectiveness as a catalyst and coordinator for international community efforts, especially under a new executive director. ASEAN and other countries should make effort to strengthen and support UNEP.

Richard Revez, *Rehabilitating Interstate Competition: Re-Thinking the Race to the Bottom Rationale for Federal Environmental Regulation*, 67 NYU L. Rev. 1210 (1992). For a review of the literature, see Daniel Esty, in *Asian Dragons & Green Trade* (Tay and Esty, eds.), 1996.

⁵³See Simon Tay, *Environmental Deterioration in SE Asia: Trade, Investment and Sustainable Development*, paper presented at US-ASEAN-Japan conference, June 1998, forthcoming.

⁵²The literature on environmental effects on economic investment and industry migration is mixed. Many theorize that there is a race to the bottom in standards to attract foreign investment and trade. Other argue that the actual cost increase from environmental standards is small and do not determine investment decisions, which are based on a much wider consideration of competitiveness. See

In term of principles, this paper has already pointed out how the practices of ASEAN in reacting to the fires differs from Principle 21 of the Stockholm Declaration, which holds out state responsibility and liability. Even if states do not set out to hold Indonesia liable, their practice should make it clear that Indonesia has obligations to cooperate and take necessary actions to abate the fires, and to accept and properly utilize assistance.

The fires also put pressure on the Biodiversity and Climate Change conventions and the emerging principles of international cooperation embodied therein. These conventions can and should find ways to bring in developing countries in ways that do not impose impediments to growth, while helping environmental protection. The Secretariats of these Conventions should join with UNEP to consider such medium to longer term measures. For instance, the Clean Development Mechanism and the concept of Joint Implementation in the Climate Change Convention can be of use in effort to deal with the fires.

Beyond UNEP and environmental institutions, another suggestion would be for economic institutions such as the World Bank and IMF would link economic assistance to environmental improvements. By this, we would not necessarily call for conditionality nor to justify sanctions, as seen in the recent case in which the IMF withheld assistance to Cambodia because of illegal and uncontrolled timber trade.

Rather, it is the suggestion of this paper that the international institutions and international community as a whole embrace the principle of additionality. The principle,

embodied in the Rio Declaration and a number of other documents that emerged from the UN Conference on Environment and Development, emphasizes that new and additional funding and assistance should be given for environmental causes. By such means, the international community might help assuage Indonesia that economic-environmental links are not eco-imperialism but legitimate efforts to further sustainable development.

Private Sector

Given the scale of the fires and their global consequences, it may seem that the private sector and individuals can do little. It is likely that some efforts, such as fire-fighting and any water-bombing, are best left to governments and inter-governmental agencies.⁵⁴ There are, however, other efforts that the private sector may usefully be involved with.

Consideration needs to be given to fostering and enforcing compliance within the relevant industries in Indonesia. This can be assisted by both internal economic measures and externally driven incentives, such as voluntary eco-labels. Such eco-labels would help consumers discriminate in favour of those companies and products that do not use fires in clearing land, thereby lessening consumer demand for those that do.

⁵⁴On the other hand, a group of expatriates based in Singapore, calling themselves the Haze-busters, has informed the press that they will focus on such fire-fighting. They have pledged to raise money to place in a trust in the Cook Islands for these purposes. As at the time of writing, however, they have not raised funds nor begun fire-fighting, beyond a few sorties in Brunei.

Similar economic incentives from the private sector can be pursued by what has been called, "ethical" funds; investment funds that pursue both profit and a good environmental record in the companies in which they invest. Private bank lending and insurance coverage too might be used to make a difference. It would be of sound economic sense for both banks and insurers to take steps to ensure that their clients have no environmental liabilities, such as the use of fire. Such investment and business practices might also be acceptable to Indonesia if they tap into new and additional funds and economic opportunities that will help their economy recover more quickly.

Conclusion

In asking the question, what we should do, we raise questions about the nature of the problem as well as the ability of countries, institutions and private sector individuals to deliver acceptable solutions.

The measures that environmental efforts turn to are often associated with political pressure by lobby groups and NGOs and sanctions, often unilaterally employed. ASEAN has expended considerable energies protesting such measures, often with success.⁵⁵ If "sticks" are predominately used, this is likely to be unacceptable to ASEAN members, both those affected by the haze, and those from which it emanates.

Instead of sticks, as such, there can be an emphasis on "carrots". In the present climate of economic concern, tying additional economic assistance and private funds to environmental problems caused by the fires would help give priority to those problems.

Increasing institutional ability and capacity -- at the national level, in ASEAN and among the relevant international institutions -- is another approach outlined in this paper. Both economic assistance and efforts to enhance institution capacity should be met not only by Indonesia and states causing the fires, but also by neighbouring states and, because of the global consequences, by the international community as a whole.

What we should do is to avoid finger-pointing and inaction. What we should do is to embrace the idea of common but differentiated responsibilities, wherein states make efforts to achieve a common goal according to their different abilities. What we should do is to emphasize the principles of cooperation that are strong in international environmental law and in ASEAN. In so doing, we may take steps that seem to some to go beyond the ASEAN way as presently conceived.

The ASEAN way may be upheld as something the grouping upholds. It should not however be taken as something sacred and immutable. To be relevant, ASEAN and the ASEAN way must evolve to meet the new challenges to inter-state and international cooperation posed by the South East Asian fires.

⁵⁵ ASEAN protest against compulsory eco-labels on tropical timber by Austria. Involvement of a number of ASEAN countries in challenging the Shrimp-Turtle laws of the USA before the WTO.

The Open and Caring Society: The Challenges of Information Technologies for Indonesia*

Fritz E. Simandjuntak

IN the past few years, perhaps no other phenomenon has been discussed as extensively and as enthusiastically as the Internet. There are, however, several very good reasons for it. Consider the following: (1) Internet provides individuals and business organizations with global connectivity 24 hours a day and seven days a week; (2) Thanks to the Web standard, 40 million users in 159 countries have access to data and information stored in 40,000 networks scattered all over the world; (3) The Internet population is expected to grow to 800 million users by the year 2000; (4) Business transactions on the Internet are expected to reach a total value of US\$1 trillion by 2000. All of the above have been, or will be, made possible by the widespread availability of information technology infrastructure, which basically blends telecommunication and computer technologies.

The rapid progress of multimedia technology not only allows people to exchange information in the written or audio format but also through high-quality, real time video or video-conferencing.

The deployment of information technology has resulted in the formation of the so-called Global Information Society. This was the basis of Alvin Toffler's argument that societies -- at least in developed countries -- ad left the two earlier stages of civilization, i.e., agricultural and industrial stages, and that they were finding themselves in the information era. To judge whether or not Indonesia has entered this era, perhaps it will be a good idea to first examine the common understanding of what the information society is. Fritz Machlup (1962) defines the information society based on its economic implications. In such a society, the dominant sector in the economic structure is the information rather than the industrial sector. In other words, the largest contribution to the economy comes from production and consumption of information instead of manufactured goods.

*Paper presented for "Societies in Transition: Asia and Europe at Moment of Change" Conference, London and Ware, March 19-23, 1998.

According to Daniel Bell (1972), an information society can be viewed as a stratification of social classes in terms of information categories. According to this view, a new stratum emerges in the existing society, comprising of information professionals who engage themselves in the production or distribution of information. Alvin and Heidi Toffler (1990 and 1994) define the information society based on its power structure. According to them, an information society is one in which the power holders are those who are capable of controlling and utilizing information to gain and maintain their power. In such a society, information replaces capital and money as the source of power in each of its dimensions -- social, political, economic and security.

As far as the structure is concerned, an information society may not differ from other societies in the history of mankind. However, it encompasses various components of civilization. The latest form of civilization may be called cyber society, net generation, virtual society, cyberworld, etc. Essentially, the information society is about a new type of civilization with a different outlook, systems, structures, or concepts for arranging social and individual lives. From this form, where does Indonesia stand at the moment? Perhaps one of the best indicators of how far Indonesia has embraced the information society is the result from a survey conducted by International Data Corporation (IDC) in 1996. According to this particular survey, Indonesia ranked as number 53 out of 55 countries surveyed in terms of Information Society Index. Indonesia was better off compared to Pakistan and China. The survey

looked into three major variables, i.e., the availability of social infrastructure, the availability of information infrastructure, and the levels of usage of computers and the Internet.

The social infrastructure is measured in terms of the levels of education, freedom of the press and freedom of expression, and the overall freedom enjoyed by the people in general. The information infrastructure is measured in terms of telephone density (the number of telephone lines per 100 inhabitants), the number of radios, TV sets, fax machines, cellular phones, and access to cable TV services. The penetration of computers and the Internet is measured in terms of the number of PCs per one hundred people, PC sales, the availability of computer education centers, the number of Internet users, etc. Based on the results of the IDC survey, it is clear that Indonesia still has a long way to go before it enters the information society.

Existing facts further indicate that Indonesia still falls behind in the provision of information to all of its people. Above all, it has been generally admitted that, in the past 30 years of our national development, we have not yet succeeded in our efforts to distribute the fruits of development equally to all parts of Indonesia. When it comes to infrastructure and utilization of information technology, it is also very clear that there are still many parts of the country that have never been touched by these modern facilities. In the telecommunication sector, for instance, the state-owned PT Telkom has installed public telephones in most rather isolated places. However, the cost of making calls

is still too expensive for many of the people living in those areas.

Thus, it is obvious that we should always take into consideration the unique complexities within the Indonesian society, both vertical and horizontal. These complexities have the potential of fettering the reintegration process of the society as we enter the information era. A recent study on urban middle classes conducted by the Sociology Lab of the Politics and Social Science Department, University of Indonesia, revealed that there were a number of factors that can threaten national integration. These were, among others: (1) Economic Disparity; (2) Monopolistic practices in the private sector; (3) Exclusivity in recruitment for elite positions, and (4) Growing feudalistic practices.

These four factors are the major threats that the government has to take care of because of their potential in causing disintegration. In the information era, people will have easier access to information and have the courage to demand fair treatment and justice. At the moment, whether we realize it or not, the transformation process towards an information society has been going on in Indonesia. So far we still have no clue of how the characteristics, the structure and the culture of the new society can fit the existing characteristics and structure of the Indonesian people. What we can be sure of is that the process is taking place, and like in other developing countries the progress towards open, information society can create unanticipated new problems. Such a process can be hampered by social and cultural conflicts, because any transformation from

a real society into a virtual one will certainly bring various impacts on the way people interact socially in the future. As members of the global information society, we will no longer stick to our general territorial and cultural identities.

The other important characteristic of the Indonesian society is that we have all the three types of communities as defined by Toffler existing simultaneously. At the same time we have those who still live in the agricultural and industrial eras while some have already leapfrogged into the information era. Each of these groups in the society has its own characteristics and value system. The gaps between them can be tremendous, and the information technology serves even to widen the gaps, thereby increasing the potential of disintegrating the nation.

The Indonesian government has designed a nation-wide program called *Nusantara 21* to rapidly construct the necessary national information infrastructure and to expedite progress in Information Technology. *Nusantara 21* combines five information technologies, i.e., satellite communications, fiber optics cable, cable TV, cellular and broadcasting technologies. Supported by relevant computer technologies and applications software, *Nusantara 21* is expected to interconnect the Indonesian archipelago through a network of networks. Its main objective is to provide equal access to information to all the Indonesian people, thereby allowing even those living in the most remote areas to access global information. Unfortunately, realization of this vision will take some time as it is hampered by severe lack of funding.

In light of the current situation, it is important to formulate the appropriate concept of Open Society for Indonesia. This particular concept has mostly been viewed negatively in the sense that it provides opportunities for interference by external forces into the country's internal processes and that it may cause national instability. During past discussions on Visions of ASEAN 2020, this concept has been directly as well as indirectly rejected, particularly as it is usually closely tied with indicators of democracy and implementation of human rights. What has been adopted as the preferred one is a vision of a "Caring Society", a society characterized by democracy, openness, humanity and respect for human rights.

The Open and Caring Society concept involves four objectives in its relation to the information technology. *First*, the Open and Caring Society should guarantee easy access to information to all classes in the society. *Second*, it should guarantee freedom to create and disseminate information in a responsible manner. *Third*, information technology should make it possible for those at the bottom to achieve vertical mobility by guaranteeing fair treatment and equal opportunities for obtaining education, for participating in politics and for doing business. *Fourth*, information technology should serve as a means to maintain national integration in the midst of the global society.

It is now clear that the development of *Nusantara 21* as Indonesia's national information infrastructure should be geared towards the achievement of the above four goals. In addition, government policies

should also ensure affordability of the services. The impending hikes in the telecommunications rates, for instance, are simply counterproductive in the sense that they will just make telecommunications services even less accessible to the underprivileged. There are steps that can be taken to alleviate such obstacles to access. For instance, the government could set special low rates for people living in impoverished villages. The rural post offices could also serve as computer and Internet centers that provide services at very low rates. We all agree that in the more advanced information societies information has become a commodity. In the Indonesian settings, however, this is not yet the fact. Information is not yet guarded and securely treated as assets. Therefore, it is also necessary to foster a conducive climate that will encourage the people to create and disseminate information.

In providing equal opportunity for education to all Indonesians, tele-education is an option that should be considered seriously. Steps should be taken to expedite adoption of distant-learning. Professors and instructors can post their course materials in their own Web pages, so that students from every corner of Indonesia can have instant access to the same quality materials as students in the big cities. Equally important, the educational institutions should also be modified to accommodate the new mode of learning. For instance, students should be able to include and add the credits obtained through distant learning towards his degree. The use of information technology for education should become the focus of government's efforts, since education is

such a strategic instrument in preparing Indonesians to become not only users but also creators and benefactors of information. Education should become top priority in infrastructure development, as it will play a significant role in increasing the level of information awareness of the people and it will also open up opportunities for new jobs and business, which, in turn, will allow for vertical mobility to happen. The Indonesian government can help make this possible by, for example, setting specific policies that will spare the rural people the costs for accessing the Internet.

Up till now the policies on information technology in Indonesia are designed on the level of awareness. The uses of Internet among government departments and officials, for instance, are largely still limited to sending and receiving E-mail. Clearly, in order to fully capitalize on the available technology, we need to move up from this level to more advanced utilization of information and related technologies. In this relation, the following more specific steps can be recommended:

1. The government should become a role model in utilizing information technology in order to achieve a higher level efficiency, to provide better services for the public and to improve openness. Databases, for instance, should no longer be independently maintained by individual departments and agencies, such as the Family Planning Board and the Central Bureau of Statistics. Rather, they should be shared on-line among these institutions.
2. The government should also start utilizing information technology to boost transparency in policy and decision making. By providing details of all effective regulation on the Web, for example, the public will be able to access them, read the requirements that they have to meet, understand the procedures that they have to follow and avoid such unnecessary burdens to their businesses as red tape and unofficial levies.
3. The appropriate culture and institutions for the information era -- including institutions necessary for exercising social controls -- should also be established, grown and empowered. Current technologies are fully capable of recording misappropriation of funds, for instance, but unless the control mechanism does not function effectively the government can never free itself from the unacceptable practices of collusion and corruption for which it has become quite widely known.
4. Finally, all necessary fundamental changes in the way the government and the public work will have to be made in order to really take advantage of the technology. A signature and a seal, for instance, may no longer be required for a document to be considered official.

Certainly, all the information technology that we have been putting in place in Indonesia promises a much better environment for working and doing business in this country. However, to really benefit from this double-edged sword, a firm political will and openness to fundamental changes are the absolute minimum prerequisites.

Indonesia's Economic Performance Under the New Order

The Effects of Liberalisation and Globalisation*

Thee Kian Wie

From Miracle to Meltdown

ON May 30, 1997, the World Bank released its annual report on Indonesia which indicated that the Indonesian economy in recent years was performing very well, with GDP (Gross Domestic Product) growing at an average annual rate of 7.7 per cent during the period 1991-1994, at 8.2 per cent in 1995, and at 7.8 per cent in 1996 (World Bank 1997: 1). Not surprisingly, a similar robust growth was being forecast for 1997.

However, only two months after the release of this report the whole picture had changed as the Indonesian rupiah, in the wake of the depreciation of the Thai baht, started depreciating steeply as domestic and particularly foreign investors and creditors began to lose their confidence in the value of the rupiah when the investment

boom in Indonesia, just like in Thailand and other Southeast Asian countries, turned out to be a mirage. By early January 1998 the gradual but steady depreciation of the "rupiah" had turned into a runaway, free-fall depreciation unprecedented in world economic history. While one US dollar was worth Rp 2,400 in early July 1997, by 22 January 1998 it was worth Rp 17,000. Hence, over this period the rupiah had depreciated by 85 per cent against the US dollar, while the stock exchange index had declined by 50 per cent.

Despite the cautiously upbeat assessment of the 1997 World Bank Report on Indonesia's economic performance, it had drawn attention to some major problems posing significant risks, including persistently high core inflation, rapidly rising private external debt, rising dependence on volatile capital inflows, increasing international scrutiny of common local practices, rising exposure to the property sector by the banking sector, and rising current account deficits (World Bank 1997: xxi, 1).

* Revised paper from a seminar on cultural, social, economic and political comparative development between Indonesia and India held in Sariska, Rajasthan, India, February 1998.

The Report also warned that problems in other East Asian economies could spill over into Indonesia, which could lead to a reversal of capital inflows. This risk was magnified by Indonesia's large external debt and the increasing sensitivity of global capital flows to changes in the above indicators (World Bank 1997: xxvi).

The events of the past eight months bear out that the above risks did in fact materialise in Indonesia as a result of the default of several financial institutions. During the past few years foreign investors and creditors, buoyed by the prospects of the booming East Asian economies, including Indonesia, and encouraged by the favourable assessments by the World Bank, the IMF, and reputable credit-rating agencies, such as Moody's and Standards and Poors, had recklessly provided huge loans to these economies for investments in the tradeable but above all in the non-trade-able sectors, particularly in property, while overlooking the systemic flaws in the financial systems and distortions and inefficiencies in these economies.

Although other East Asian countries had also been experiencing a severe financial meltdown, none of them was experiencing a currency depreciation of the magnitude being experienced by Indonesia. Initially the runaway rupiah depreciation was indeed caused by the contagion effect of the currency crises afflicting Thailand and subsequently other Southeast Asian countries, including Malaysia and the Philippines. Following the currency crisis in Thailand, foreign investors and creditors undertook a wide-ranging reassessment of the considerable risk exposures in Indone-

sia (overinvestment in property, the weak and undersupervised banking system, large and rising foreign debt, the rising current account deficit, policy-induced microeconomic distortions, and political uncertainty surrounding succession). The sudden concern of these foreign investors and creditors was in particular focused on the large, unhedged, short term, off-shore loans which many Indonesian firms and their bankers had taken during the past year. The newly perceived risk was that these firms would be suffering big losses if the rupiah would, like the baht, also depreciate. It was feared that this, in turn, could very likely lead to a proliferation of bad debts among the Indonesian banks, some of which were known to be very weak (McLeod 1997: 42-43).

As concern about this new risk exposure turned into panic, foreign and domestic investors alike started selling their shares in listed companies, especially those considered vulnerable to foreign exchange risk, in order to reduce their own risk exposure. Subsequently, these investors attempted to convert the rupiah proceeds from these sales into American dollars or other strong foreign currencies. (McLeod 1997: 43). As pressure on the rupiah increased, the rupiah began to depreciate against the upper boundary of the intervention band. Although the intervention widened was widened further, pressure on the rupiah continued unabated. Having witnessed the costly and ultimately unsuccessful attempt of the Bank of Thailand to maintain the fixed exchange rate with the American dollar, the Bank of Indonesia on August 14, 1997, floated the rupiah.

The move to a floating exchange rate, however, only confirmed the worst fears of both investors and the wider public that what had happened in Thailand could also happen in Indonesia (McLeod 1997: 43). As people attempted to get rid of their rupiah holdings as fast as possible and convert them into dollars or other strong foreign currencies, the free-floating rupiah continued depreciating even further, thus further confirming the worst fears about the inexorable downward trend of the rupiah.

As foreign and domestic investors and companies with unhedged foreign loans, particularly short-term loans, scrambled to purchase US dollars or other foreign currencies, the rupiah began to depreciate, first slowly but then at an accelerating rate. Despite concern about these developments, the initial response of Indonesia's economic policy-makers was not panicky as the "economic fundamentals" (low rate of inflation, rising but still manageable current account deficit) of the country were deemed to be basically sound. However, as the rupiah continued to depreciate after the Bank of Indonesia abandoned its "managed float" exchange rate policy in favour of a "freely floating" exchange rate on August 14, 1997, the Indonesian government in early September 1997 turned to the International Monetary Fund (IMF) for a rescue package to help Indonesia solve the currency crisis. However, when the Indonesian government in late September allowed 15 large-scale, capital-intensive projects to go ahead despite its agreement with the IMF to defer or cancel a large number of these costly projects, a widespread impression arose that the Indonesian

government was not serious in implementing the policy reforms as agreed upon with the IMF. These doubts led to a further depreciation of the rupiah.

When on January 8, 1998 the government released a draft government budget which was considered quite unrealistic, the rupiah depreciation turned into a free-fall with the rupiah depreciating to more than Rp 10,000 against the US dollar. Even the new agreement which the Indonesian government had signed with the IMF on 15 January 1998 to implement a wide-ranging reform program failed to stabilise the value of the rupiah. In fact, on 21 January 1998 the rupiah reached a new low of Rp 16,500 against the US dollar. As a result, panic gripped the public, particularly people in the urban areas, which led to a rush on supermarkets to buy up large quantities of basic wage goods, such as rice, sugar, and cooking oil. The resulting shortage of these goods continue to be a matter of great concern to the public.

The continuing depreciation of the rupiah in late January 1998 has been attributed to the fact that the new agreement with the IMF did not contain any provision to solve the large private sector debt (estimated at US\$65 billion), particularly the short-term debt (estimated at US\$40 billion), which had to be serviced within the next few months. The reason for this omission was that both the Indonesian government and the IMF did not consider the settlement of the large private debts to be their responsibility (Sadli 1998). In their view the Indonesian debtors themselves should discuss with their creditors the settlement or roll-over of their

debts. Responding to this criticism, the Indonesian government subsequently set up a committee, headed by Radius Prawiro, a former cabinet minister, and consisting of several representatives of the private business sector, to negotiate with the foreign creditors a satisfactory settlement of the repayment of these debts, including a rollover of these debts. Thus far, however, it is not yet clear whether these negotiations have led to a mutually satisfactory settlement.

However, in view of the political uncertainty about the country's leadership, most foreign creditors apparently are waiting for the situation to clear up in late March 1998 after the appointment of a new President and Vice President by the People's Consultative Assembly (MPR), the highest legislative assembly in the country. In addition, much attention will be focused on the credibility and integrity of the persons who will be appointed to the crucial economic positions, particularly the Coordinating Minister for Economics and Finance and Development Supervision, the Minister of Finance, the Governor of the Bank of Indonesia, and the Minister for Trade and Industry.

Aside from the contagion effect, several Indonesian economists have attributed the steep depreciation of the rupiah to a more deep-seated factor, namely the loss of public confidence in the Indonesian government. For instance, in a widely published warning Professor Sumitro Djojohadikusumo, the doyen of Indonesian economists and former cabinet minister, attributed this loss of public confidence to a series of what he called institutional diseases, such as extensive corruption, collu-

sion between government officials and businessmen, government-sanctioned monopolies, legal uncertainty, and a weak judicial system. Sumitro warned that getting out of this crisis would require immediate and firm action, specifically by attacking these institutional diseases in a more focused manner, despite the anticipated strong resistance from groups with vested interests in hampering the implementation of these reforms (Djojohadikusumo, 1998).

Other critical Indonesian economists have also drawn attention to other basic factors, particularly a wide range of policy-induced micro-economic distortions, such as various regulations and restrictions on domestic competition, which over time had adversely affected the resilience of the Indonesian economy to weather external shocks successfully.

As a result of the runaway rupiah depreciation, the Indonesian economy is slowly but inexorably grinding to a halt. Saddled with debts they cannot repay, dwindling revenues as a result of the reduced purchasing power of the public due to the cost-push inflation caused by the steep rupiah depreciation, and the inability of many companies to import expensive raw materials and other intermediate inputs as most overseas banks refuse to accept the letters of credits (LCs) issued by Indonesian banks on behalf of the Indonesian importers, production in many manufacturing enterprises, including large as well as small-and medium-scale enterprises (SMEs), is being cut down severely or halted completely. In addition, the construction sector has collapsed following the technical bankruptcy of most real estate companies. As a result, a large

and steadily rising number of workers, estimated at a few million, are being laid off.

Hence, as a result of the slowdown in the economy, the incidence of absolute poverty, which had steadily declined over the past three decades, is likely to rise again as many "near poor" and unemployed people are dropping below the poverty line again. Thus one of the proudest achievements of the New Order government which came to power in 1966, namely the sharp reduction in absolute poverty, is being evaporated as a result of the most serious economic crisis now be setting Indonesia.

In addition to the severe financial crisis, Indonesia is currently also facing an emerging food crisis in Indonesia as a result of the severe and long drought, associated with El Nino, which has significantly delayed and reduced the main rice harvest on Java, the most densely populated island with a population of almost 118 million people. As the food buffer stocks held by the Food Logistics Agency (Bulog) have declined sharply, the supplies of rice, Indonesia's main staple food, are likely to decline further as Indonesian rice importers are unable to open credible letters of credit (LCs) with overseas banks (Timmer 1998: 1). This food crisis is also being aggravated by the fact that a large and steadily rising number of low wage, low skill workers have been laid off. These workers generally purchase food out of their daily or weekly relatively meager wages (Timmer 1998: 1).

The severe financial crisis which has affected all East Asian economies to a greater or lesser degree has forced eco-

nomists and other social scientists to take a new and more critical look at the so-called "East Asian Miracle". Despite the necessity of taking a much more critical look at the economic performance of the East Asian "Miracle" economies, including Indonesia, referred to as the "high-performing Asian economies" (HPAEs) by the World Bank in its study on "The East Asian Miracle" (World Bank 1993: xvi), Indonesia has undoubtedly made rapid progress in its economic and social development over the past three decades. Despite the danger that this progress is being rapidly eroded by the serious financial and economic crisis facing the country, a closer look needs to be taken at the policy decisions of the New Order government which made Indonesia's economic achievements possible. *First*, however, a brief overview will be given of Indonesia's economic performance under the New Order government.

As the first draft of this paper was presented at the Conference on Identity, Locality, and Globalisation, held in Sariska, Rajashtan, India, which was devoted to a comparison of the experience of Indonesia and India, Indonesia's economic performance over the past three decades will, wherever possible, be compared to India's economic performance.

Indonesia's Economic Performance Under the New Order Government: An Overview

Growth and Transformation

Until the currency crisis hit Indonesia with a vengeance in July 1997, the coun-

try during the past three decades was able to achieve rapid and sustained economic and social progress which by the early 1990s had put it in the group of what the World Bank has termed the "high-performing Asian economies" (HPAEs). (World Bank 1993: xvi). While several other developing countries have also experienced periods of rapid economic growth, only a few of them, including Indonesia, have managed to sustain rapid growth over a period of three decades (Birdsall, et. al., 1995: 478).

Indonesia's economic performance is the more remarkable as it should be set against the economic stagnation and chaos of the late 1950s and early 1960s under the so-called "Old Order" government, when Indonesia experienced hyperinflation reaching 660 per cent in 1966, output stagnated, and export earnings fell steadily. This economic performance is also remarkable as

during this period the Indonesian economy was also buffeted by various external shocks, particularly the two oil booms of the 1970s and the severe weakening of the oil market in the early and mid 1980s.

During the period 1965-1995 economic growth grew at an average annual rate of 6.9 per cent (Table 1).

With population growing at an average annual rate of 2.4 per cent during the period 1971-80 and slowing down to an average annual rate of 1.8 per cent during the period 1980-95 as a result of a successful family planning program, per capita income in Indonesia has risen from US\$100 in the mid 1960s to around US\$1000 in 1995, putting Indonesia in the ranks of the "lower middle income economies". However, as a result of the recent financial crisis and the likely economic stagnation in the next few years, per capita income is likely to decline again, certainly in US

Table I

ECONOMIC GROWTH IN INDONESIA AND INDIA, 1965-1995

Country	Growth (% growth) Gross Domestic Product (GDP)			Agriculture (% growth ¹)			Manufacturing (% growth ²)			Services (% growth)		
	1965-80	1980-90	1990-95	1965-80	1980-90	1990-95	1965-80	1980-90	1990-95	1965-80	1980-90	1990-95
Indonesia	7.0	6.1	7.6	4.3	3.4	2.9	12.0	12.6	11.2	7.3	7.0	7.4
India	3.6	5.8	4.6	2.5	3.1	3.1	4.5	7.4	5.4	4.4	6.7	6.1

- Notes: 1) *Agriculture*: Comprises value added from the cultivation of crops, forestry, hunting, fishing, and livestock production;
- 2) *Manufacturing*: Refers to industries belonging to divisions 15-37 in the International Standard Industrial Classification (ISIC);
- 3) *Services*: Include value added from wholesale and retail trade (including hotels and restaurants), transport, government, and financial, professional, and personal services (including education and health care), and real estate services.

Source: ¹For 1965 figures: World Bank, 1992, *World Development Report 1992 - Development and the Environment*, Oxford University Press, World Development Indicators, Table 2, pp. 220;

²World Bank, 1997 (b), *World Development Indicators 1997*, IEC Information Center, Development Data Group, Washington, D.C., Table 4.1, pp. 130-133.

dollar terms. As a result of rising inflation, the real incomes of the Indonesian population is also declining rapidly.

Compared to Indonesia, India's economic performance during the past three decades has been less impressive due to the slower growth of the agricultural, manufacturing, and services sectors. Manufacturing growth, in particular, has been much slower in India than Indonesia because of India's strongly inward-oriented pattern of industrialisation which strongly favoured production for the domestic market. Indonesia, on the other hand, since the early 1970s through the mid 1980s pursued a moderately inward-oriented pattern of industrialisation which distinctly favoured production for the domestic rather than the export market (World Bank 1987: 82-83). Because the overall incentive structure of Indonesia's trade regime was only moderately inward-oriented, it has been easier for Indonesia to modify its incentive structure since the mid 1980s towards a more outward-oriented bias, when the end of the oil boom made it necessary to increase non-oil exports, particularly manufactured exports, to offset the decline in oil export earnings. In particular, the Indonesian government since the mid 1980s had introduced a series of deregulation packages with a view to improve the investment climate for private investors, including foreign investors, and promote a more efficient private sector. In addition, the government, though not without difficulty, also introduced a series of trade reforms with a view to reduce the "anti-export bias" in its trade regime. The result of these policy reforms was a surge in manufactured exports, particularly low skill labour-intens-

ive manufactured exports, since the late 1980s which for the first time put Indonesia on an export-led growth path similar to the one traversed earlier by the North-east Asian newly-industrialising economies (NIEs).

Since the early 1990s India too has started pursuing a more outward-looking pattern of industrialisation. However, the result of this recent, more outward-oriented shift in India's trade regime has not yet resulted in a higher growth rate of the manufacturing sector.

The data in Table 1 show that Indonesia's rapid economic growth has been underpinned by rapid growth of all the three major sectors, agriculture, manufacturing, and services, particularly manufacturing. In fact, during the past three decades Indonesian manufacturing has grown at double digit rates. During the late 1960s and early 1970s this rapid industrial growth was fuelled mainly by the liberalisation of economic policies, particularly the trade regime, and the return to normal economic conditions after the economic chaos of the early 1960s. During the oil boom period of the 1970s through the early 1980s state-directed import-substituting industrialisation was extended to the upstream industries (second-stage import substitution). This led to a rapid but inefficient (and ultimately unsustainable) rapid industrial growth. After the oil boom period, and particularly since the mid 1980s, rapid industrial growth was, as mentioned above, driven by manufactured exports and the private sector as a result of the successive policy reforms (Hill 1996: 154-55). As a result, by 1995 Indonesia had in terms of manufacturing value

added the seventh largest manufacturing sector among the developing countries after China, Brasil, South Korea, Mexico, Argentina, and India (World Bank 1997 (b): 134-36).

Because Indonesia had since the late 1980s also been able to raise its manufactured exports rapidly following its shift from import-substituting to export-oriented policies, it has since the early 1990s also been tagged as one of East Asia's "newly-industrialising economies" (NIEs) by the World Bank along with Malaysia and Thailand (World Bank 1993: xvi). Moreover, following the end of the oil boom in the early 1980s, Indonesia's manufacturing sector has since the mid 1980s gradually but steadily replaced the oil sector as the major engine of economic growth and as the major source of export earnings.

Indonesia's agricultural sector has also been performing quite well, particularly during the 1970s and 1980s. To a large extent rapid agricultural growth was fuelled by rapid growth in cereal production, particularly rice, Indonesia's staple food. According to the Food and Agricultural Organisation (FAO), Indonesia's growth in per capita cereal production between 1974/75 and 1984/85 was the second highest in Asia after Myanmar. This performance was in sharp contrast to that of the 1950s and early 1960s when Indonesia's agricultural growth was the slowest among the major Asian countries (Booth 1988: 1). Indonesia's good agricultural performance during this period was also remarkable, as it contrasted quite sharply with the other oil-exporting countries, such as Nigeria, Algeria, Venezuela, and Ecuador, where the growth of agricultural output either stagnated or

declined (referred to as "de-agriculturalisation") as a result of the adverse effects of the so-called "Dutch Disease" following resource booms (Booth 1988: 1-2).

The success of the New Order government in increasing the output of food crops, particularly rice, was due to the great importance it put on providing adequate supplies of rice, the country's major staple food. To this end it carried out with great vigour rice-intensification programs, such as the Bimas (*Bimbingan Massal*, Mass Guidance) program introduced earlier by the previous government and the Inmas (*Intensifikasi Massal*, Mass Intensification) program. In its efforts to raise rice production, the Indonesian government was able to benefit enormously from the introduction and spread of fertiliser-responsive seed technology, developed by the International Rice Research Institute (IRRI) in Los Banos, the Philippines. To support the rice intensification program, the government also undertook to rehabilitate and expand existing irrigation, particularly on Java. In addition, in the islands outside of Java, particularly on Sumatra, the government also attempted to increase rice cultivation on tidal lands (*pasang surut*) and to develop rice estates (Mears and Moeliono 1981: 34).

The government also established Bulog (*Badan Urusan Logistik*, Food Logistics Agency), a food stock authority charged with stabilising the price of rice by holding adequate reserve stocks of rice, while also supporting a floor price for rice in order to stimulate rice production and contribute to the farmer's welfare (Mears & Moeliono, 1981: 33-34).

The data in Table 1 show that agricultural growth in the 1980s was slower than in the 1970s due to the depressed markets for agricultural commodities, a slowdown in the expansion of the land frontier, ecological limits on further increases in cropping intensity, and the near-completion of the technological advances of the green revolution for rice (Tabor 1992: 162). Nevertheless, the steady expansion of rice production since the early 1970s enabled Indonesia to achieve rice self-sufficiency in 1985.

Agricultural growth has further slowed down in the 1990s as a result of the slowdown in irrigation investment and the cropping intensities on irrigated land approaching their technological maximum (Tabor 1992: 198). To sustain agricultural growth, the government will need to pay greater attention to diversify agricultural activities away from its focus on rice production and promote the production of non-rice food crops as well as of tree crops which in the past have received much less attention than rice.

Since Indonesia's manufacturing sector and to a lesser extent the services sector

has been growing faster than the agricultural sector, the Indonesian economy over the past three decades has also experienced a rapid structural transformation, as shown in Table 2.

During the past three decades the relative importance of agriculture in the Indonesian economy, despite the steady rise in agricultural output in absolute terms, has declined to such an extent that in 1995 it accounted only for a third of its relative importance in 1965. On the other hand, sustained double digit growth of the manufacturing sector has enabled this sector to treble its relative importance during the same period. With manufacturing now contributing more than 20 per cent of GDP, Indonesia by the standards of UNIDO (United Nations Industrial Development Organisation) can be classified as a "semi-industrial economy".

Despite the fact that India has started its process of industrialisation much earlier than Indonesia did, in fact since the mid-nineteenth century when India was still a British colony, and with a stronger technological and human skill base than Indonesia,

Table 2

ECONOMIC TRANSFORMATION IN INDONESIA AND INDIA, 1965-1995

Country	Gross Domestic Product (GDP)		Distribution of GDP					
	(millions of US\$)		Agriculture		Manufacturing		Services	
	1965	1995	1965	1995	1965	1995	1965	1995
Indonesia	5,980	198,079	51	17	8	24	36	41
India	50,530	324,082	44	29	16	19	34	41

Source: 1. For 1965 figures: World Bank; 1992, *World Development Report 1992 - Development and the Environment*, Oxford University Press, Table 3, pp. 222;
 2. For 1995 figures: World Bank, 1997 (b): *World Development Indicators, 1997*, IEC Information Center, Development Data Group, Table 4.2, pp. 135.

its industrial growth during the past three decades has been, as table 1 shows, quite sluggish, particularly because of its strong inward-orientation. Hence, India's economic transformation has also been less dramatic than Indonesia, as reflected by the fact that in 1995 Indian manufacturing still contributed only 19 per cent to GDP. By UNIDO's standards India, with manufacturing accounting for less than 20 per cent of its GDP, is still an 'industrialising' rather than a 'semi-industrial' economy as Indonesia is.

Economic Welfare

Another feature of Indonesia's remarkable economic performance during the past three decades has been the rapid decline in the incidence of absolute poverty. For instance, during the period 1972 - 1982 the percentage of Indonesia's population below

the poverty line fell from 58 per cent to 17 per cent. In terms of absolute numbers this implied a decline in the number of poor people from 67.9 million to 30 million. (World Bank 1993: 33). By 1990 the percentage of people below the national poverty line had dropped to 15.1 per cent (or 26.9 million people). (Table 3). This steep reduction in absolute poverty has been quite remarkable, even in comparison with other developing countries. For instance, a comparative study by the World Bank on the performance of a number of developing countries revealed that Indonesia during the period 1970 - 1987 has been the most successful in reducing poverty. (World Bank 1990: 45).

To a large extent the fall in poverty since the mid 1970s has been due to the fall in poverty in rural Java. The reason for this fall has been the rapid growth in the availability of off-farm employment opportunities for

Table 3

POVERTY AND INCOME (OR CONSUMPTION) DISTRIBUTION IN INDONESIA AND INDIA

Country	National poverty line ¹	International poverty line		Gini index ⁴
	Population below poverty line (%)	Population below \$1 a day (PPP) ²	Poverty gap (%) ³	
Indonesia	15.1 (1990)	14.5 (1993)	2.0 (1993)	31.7 (1993)
India	-	52.5 (1992)	15.6 (1992)	33.8 (1992)

- Notes:
1. *National poverty line* is the percentage of population living below the poverty line deemed appropriate for the country by its authorities;
 2. *Population below \$1 a day* is the percentage of the population living on less than \$1 a day at 1985 international prices, adjusted for purchasing power parity;
 3. *Poverty gap* is the mean shortfall below the poverty line (counting the non-poor as zero shortfall) as a percentage of the poverty line. This measure reflects the *depth* of poverty as well as its incidence;
 4. *Gini index*, measures the extent to which the distribution of income (or consumption expenditures) among individuals or households within an economy deviates from a perfectly equal distribution. Thus a Gini index of zero represents perfect equality, while an index of 100 implies perfect inequality.

Source: World Bank 1997 (b); World Bank Development Indicators, 1997, IEC Information Center, Development Data Group, Table 2.5, pp. 51; Table 2.6, pp. 55, pp. 57.

rural households. This, in turn, was made possible by the rapid growth of agricultural production, particularly rice, which led to the generation of new jobs in agricultural processing, transport, and commerce, as well as the rapid growth of the construction and manufacturing sectors in both rural and urban Java. (Booth 1992: 639).

One shortcoming of the poverty estimates based on Indonesia's national poverty line (as developed by the Central Bureau of Statistics) is that it is not only far lower than the ones used in the neighbouring countries, but even lower than the ones used for the poorest countries in the world. (Booth 1992: 637). However, even higher poverty lines would show an unmistakable downward trend in the incidence of absolute poverty, even though higher poverty lines would naturally show a higher incidence of absolute poverty than under the national poverty line.

Since various countries use different poverty lines, international comparisons of the incidence of absolute poverty is quite difficult. To solve this problem, the World Bank has attempted to develop an international poverty line. This line has been set at \$1 a person a day, expressed in 1985 international prices, and adjusted to local currency using exchange rates aimed at assuring purchasing power parity for consumption. (World Bank 1997(b): 50).

Using the international poverty line as a basis to compare the incidence of absolute poverty in Indonesia and India reveals that the proportion of poor people in Indonesia is much lower (less than one third) than in India (Table 3).

In order to know the depth of poverty (as distinct from the incidence of poverty) in a country, the concept of poverty gap has been developed. This poverty gap refers to the mean shortfall below the poverty line expressed as a percentage of the poverty line. Using this concept, the data in Table 3 show not only that the incidence, but also the depth of poverty (poverty gap) in Indonesia is less serious than in India.

However, one of the most disturbing adverse effects of the devastating financial and economic crisis which has hit Indonesia since mid 1997, is that the incidence and depth of absolute poverty in Indonesia is likely to increase again, as millions of mostly low skill workers have been laid off as hundreds, if not thousands of small, medium, and large companies, particularly in the manufacturing and construction sectors, have either halted production for the lack of imported raw materials, parts, and components they cannot afford to pay anymore because of the "hyper-depreciation" or because they have gone bankrupt. In addition, the real incomes of the large majority of Indonesians have in recent months declined as the prices of virtually all goods and services have gone up steeply as a result of the cost-push effects of the "hyper-depreciation" of the rupiah.

Unlike Indonesia and the other Southeast Asian countries, India has thus far not been hit by the currency crises as it has, unlike the Southeast Asian countries, not yet liberalised its financial markets. In other words, India's financial markets have not yet been integrated with the international financial markets as Indonesia's have.

Another indicator of economic welfare is the concept of relative inequality, which refers to the distribution of income (or consumption) in an economy. A common measure to estimate the extent to which the distribution of income (or consumption expenditures) within an economy deviates from a perfectly equal distribution is the Gini index. Using this indicator as a measure of the maldistribution of income reveals that income distribution in Indonesia was slightly more equal than in India. (Table 3). Nevertheless, in both countries income distribution (with Gini indices ranging between 31.7 and 33.8) was moderately unequal compared to many other developing countries.

Despite the above statistical evidence, however, there is a widespread and deeply-held view in Indonesia that economic growth has been grossly unequalising and therefore has widened the economic disparities between the rich few and the poor masses. Insofar as unequal distribution of income reflects an unequal distribution of wealth (or productive assets), rapid economic growth has indeed led to asset concentration, both physical assets (land, shares in companies, factories, banks, and other economic entities) and non-physical assets (educational opportunities, particularly elite secondary school education and opportunities to pursue tertiary education overseas) by the privileged groups in society. However, as there are no data, except circumstantial evidence, on wealth or asset distribution, there is no way to satisfactorily support the assertion that economic disparities in Indonesia have indeed widened during the past few decades.

Economic Policies Under the New Order Government

An Overview of Economic Policies under the Sukarno Government

To the extent that protectionist import substitution policies, a highly regulated domestic economy, a preference for resource self-sufficiency, and restrictive policies towards foreign direct investment, are the major features of what professor Hla Myint of the London School of Economics (LSE) has called "pure inward-looking policies", the economic policies pursued by the old government under President Sukarno, particularly since the late 1950s up to its replacement by the New Order government in the mid 1960s, could indeed be described as "inward-looking policies", although not of the "pure" type as characterised by Hla Myint. (Myint 1984: 41). International trade was to an increasing extent being controlled, primarily for balance of payments reasons. (Myint 1984: 43), while foreign direct investment was regarded with great hostility. The hostile stance towards foreign investment during the early post-colonial years of the 1950s and early 1960s was not surprising in view of the potent force of economic nationalism to "convert the colonial economy into a national economy" owned and controlled by nationals rather than by foreigners or "non-indigenous" nationals. (Thee 1996: 325-28).

Despite the heroic calls for the country "to stand on one's own feet" (*berdiri di atas kaki sendiri, Berdikari*), Indonesia's economic policies under the old government could not be considered as "pure" inward-looking policies because of the country's dependence

on foreign aid. Since the old government was pursuing import-substitution policies, the resulting balance of payments problems required the government to turn to official foreign aid to alleviate its foreign exchange shortage. (Myint 1984: 42-43).

As Indonesia's relations with the Western countries deteriorated in the early 1960s because of its "Crush Malaysia" campaign and the increasingly closer relations with the People's Republic of China (PRC), Indonesia grew increasingly dependent on foreign aid from the communist bloc countries, particularly the Soviet Union and to a lesser extent on the East European socialist countries and China.

Economic Policies under the New Order Government

The New Order government which took over power in 1966 largely abandoned the "inward-looking" economic policies of its predecessor in favour of more "outward-looking" policies, particularly in regard to its foreign trade regime, foreign exchange regime, and its foreign investment policy, which were all substantially liberalised. In other words, the New Order government created a more open economy by re-integrating the economy into the world economy. (Hollinger 1996: 25). The shift to "outward-looking" policies was particularly evident with the enactment of a new Foreign Investment Law in 1967, which opened virtually all fields of economic activity to foreign direct investment (FDI), except for a limited number of fields, such as public utilities, mass media, and nuclear power stations, which for the sake of the national or public

interest or national security, should remain in the hands of Indonesian nationals or the government. The new liberal (open-door) policy towards foreign investment was quite successful in attracting new foreign investment, as reflected by the steadily rising numbers of approved foreign investment projects from 29 in 1967 alone to 77 in 1968 and to 118 in 1969. (Sadli 1972: 204-05).

Indonesia's liberal foreign investment policy, however, lasted only for a brief period as since early 1974 Indonesia's policy towards foreign investment became increasingly restrictive. The direct impetus to a more restrictive foreign investment policy were the serious urban riots in January 1974 which were directed at the perceived "over-presence" of Japanese investment in Indonesia. The increasingly restrictive policy towards foreign investment, however, also turned out to be in line with a more general thrust towards a greater government intervention and regulation of the economy since the mid 1970s when more government revenues in the form of resource-rent taxes accrued to the government as a result of the two oil booms of the 1970s.

The new restrictions on existing and new foreign investment basically involved the requirement for speedier "Indonesianisation" in the operations of foreign-controlled firms, particularly in regard to equity ownership (divestment rules for foreign investors), management and personnel, and increased "local content" as well as an increase in the number of fields closed to new foreign investment. Furthermore, since 1974 foreign investors were not permitted anymore to set up fully-owned subsidiaries but, instead, could only enter Indonesia through the es-

establishment of "joint ventures" with local partners.

A similar return shift from "outward-looking" back to "inward-looking" policies also took place in regard to domestic and particularly foreign trade. After an initial liberalisation of the foreign trade regime in the late 1960s, tariff and non-tariff barriers (NTBs) soon began to proliferate again, particularly since the mid 1970s, even though import restrictions were actually no longer needed for balance of payments reasons. (Myint 1984: 43).

In line with the "structuralist" approach to industrialisation promoted by the then Minister of Industry, A.R. Soehoed (1978-1983), the Indonesian government, flush with greatly increased government revenues from the oil booms of the 1970s, embarked on an ambitious state-led industrialisation program which involved the establishment of upstream, basic resource-processing industries, to be set up by state-owned enterprises (SOEs), as well as engineering goods industries to be set up largely by private investors, including foreign investors who were still welcome to enter upstream industries. Naturally, the implementation of this "second stage" import-substituting industrialisation program required a highly protectionist trade regime in order to protect the "infant" up-stream industries. As noted above, this highly inward-looking pattern of industrialisation was gradually abandoned in the mid 1980s in favour of a more export-oriented pattern of development.

Another important feature of the shift to "outward-looking" policies was the establishment of a free and open foreign exchange market in 1970. To this end the government

began to abandon the erstwhile multiple exchange rate system in favour of a single rate market. The government also maintained a managed float for its exchange rate. In addition, the government also abandoned foreign exchange control and made the rupiah convertible at a time when virtually no other developing country was doing this. (Hollinger 1996: 28-29). In other words, Indonesia since 1972 had liberalised its capital account, which implied that movements of capital into or out of the country could freely take place without any restrictions by the government. It is of interest to note that the sequencing of economic policy reforms undertaken by the New Order government was exactly the reverse of the conventional sequencing of reforms advocated by economists, namely first trade liberalisation followed by liberalisation of the financial sector, and only then liberalisation of capital markets. (James & Stephenson 1993: 6- 7). However, in the case of Indonesia the economic policy-makers decided to liberalise capital transactions first in order to attract private foreign investment.

Rising FDI inflows into Indonesia since the late 1960s testified to the effectiveness of an "open" capital account in attracting foreign investment. (James & Stephenson 1993: 15-16). In fact, this "open" capital account has been a major feature of Indonesia's economic policies under the New Order and has thus far been consistently adhered to, even during the present serious financial crisis. Even though during the past few months there has been calls to reintroduce foreign exchange controls in order to stem the hemorrhage of US dollars and other foreign exchange, the experience with foreign exchange controls under the former

government has indicated that such controls are rarely, if at all effective, and moreover create 'black markets' and the attendant problems of corruption.

Like the former government, the New Order government continued to depend on foreign aid, even to a much larger extent than its predecessor. In fact, throughout the whole New Order era up to the present foreign aid on concessional terms has played a crucial role as one of the three major sources of government revenues, in addition to the oil and gas revenues (i.e. direct taxes on the oil and gas companies) and the non-oil domestic revenues (NODRs), including the other direct taxes (income and corporate taxes) and indirect taxes, particularly the value added taxes (VATs), as well as non-tax revenues, such as the profits of the SOEs. The great importance of official foreign aid flows is indicated by the fact that during the period 1967 through 1992 foreign aid as a percentage of government revenues has ranged between 12 to 30 percent. (Hill 1996: 46-47).

Because of the considerable goodwill towards the new Indonesian government on the part of the Western countries and Japan as well as the multilateral organisations, such as the World Bank, the International Monetary Fund (IMF), and the Asian Development Bank (ADB), and their confidence in Indonesia's economic stabilisation and rehabilitation program which had been prepared by Indonesia's economic technocrats with the full support of President Soeharto (Sadli 1993: 42), since the late 1960s new aid has flown into Indonesia in increasing amounts.

The fall in oil prices in 1982 as a result of the weakening world oil market and

an even steeper fall in the price of oil in early 1986 forced the Indonesian government to carry out tight fiscal and monetary policies to restore macroeconomic stability. These macroeconomic stabilisation measures testified to the great importance which the New Order government from the outset has attached to macroeconomic stability, that is low rates of inflation (i.e. single digit rates of inflation) and low current account deficits (preferably accounting for a maximum of two per cent of GDP).

In addition, the government also undertook a structural adjustment program to restructure the economy away from its heavy dependence on oil as the largest source of foreign exchange earnings and government revenues. To this end the government carried out various structural reforms to create a more diversified and more efficient economy, including tax reforms to tap more sustainable sources of government revenues, financial reforms to liberalise the highly regulated domestic financial sector and improve financial intermediation, and trade reforms to reduce the "anti-export bias" of Indonesia's protectionist trade regime. The government also introduced a series of deregulation measures to improve the investment climate for private investors, including foreign investors. Hence, since the mid 1980s the New Order government once again carried out a major policy shift by shifting back from "inward-looking" to "outward-looking" policies. In essence, this was the second attempt on the part of the New Order government to create a more open economy.

The successive deregulation measures and other policy reforms (particularly the trade reforms) since the mid 1980s turned

out to be successful in stimulating more private capital investment, both by domestic and private sector, particularly in export-oriented industries. In turn, these investments contributed to a surge in non-oil exports, particularly manufactured exports, which enabled Indonesia to rapidly reduce its high dependence on oil and gas exports as a source of foreign exchange earnings. In fact, the share of manufactured exports as a share of total exports has risen from 10.6 per cent in 1981 to 64.5 per cent in 1996. (Biro Pusat Statistik, August 1997).

However, although manufactured exports have been steadily rising since 1987, the growth of these exports has been slowing down since 1993, particularly the unskilled labour-intensive and resource-intensive manufactured exports, not only because of the weakness of some of its export markets, but also because of strong competition from other low wage, newly-exporting countries (NECs), including China, Vietnam, India, and Bangladesh. Hence, to sustain its manufactured export growth, Indonesia will have to develop a more sustainable source of comparative advantage, in particular by developing more skill- and technology-intensive industries. This would require the development and improvement of the industrial technological capabilities (ITCs) of its manufacturing firms, both small and large. In turn, this would require a continued improvement in the incentive system (primarily the trade regime and domestic competition policies) facing manufacturing firms which would put pressure on these firms to invest in greater ITCs.

The development of greater industrial technological capabilities would also require Indo-

nesia to undertake a substantial improvement in the country's supply-side capabilities, particularly by a more comprehensive and focused effort to improve the skills of its labour force and raise the effectiveness of its domestic science and technology (S & T) institutes to render the necessary technology support services to the manufacturing firms, including the large as well as small and medium-scale enterprises (SMEs). (Thee 1997: 13-14).

The Globalisation of the Indonesian Economy

The shift back to "outward-looking" policies since the mid 1980s has led to a more open economy, which in turn has led to a greater integration with the world or global economy. This greater internationalisation or globalisation of the Indonesian economy has been in line with the rapid pace of global economic integration which during the past decade has accelerated dramatically, as reflected by the rapid rise in the ratio of world trade to world GDP and the equally rapid rise in the ratio of total foreign direct investment (FDI) to world GDP. In general, a majority of the developing countries has over the past decade also participated extensively in the acceleration of global integration. (World Bank 1997(b): 295).

The greater internationalisation or globalisation of the Indonesian economy is reflected by some quantitative indicators, notably the percentage of real trade as a share of GDP, the institutional investor credit rating of a country, net foreign direct investment (FDI) as a share of GDP converted to international dollars using purchasing power parities (PPPs), and the share of manu-

factured exports in total exports (World Bank 1997(b). 293-95), as shown in Table 4.

To better assess the extent of the globalisation of the Indonesian economy, data on the extent of globalisation of the Indian economy are also presented in Table 4.

The data in Table 4 indicate that in general the Indonesian economy is more integrated with the world or global economy than India is. In fact, during the early 1980s the share of Indonesia's real trade (i.e. the sum of exports and imports of goods and services measured in constant prices) in the country's GDP was almost 27 per cent, that is 3.6 times higher than India's level. Similarly, during the same period the institutional investor credit rating of Indonesia was

higher than that for India. This implied that Indonesia had a smaller chance for default than India. Similarly, the share of net foreign direct investment as a share of "purchasing power parity" (PPP) GDP was slightly higher in Indonesia than in India. On the other hand, in the early 1980s the share of manufactured exports in total exports was much higher in India than in Indonesia.

The data in Table 4 also show that during the past decade the pace of Indonesia's integration with the global economy has in general been faster than that of India, as reflected by the fact that the institutional investor credit rating of Indonesia during the period 1980/82 to 1990/92 has improved, while that of India has deteriorated. Simi-

Table 4
INTEGRATION OF THE ASEAN COUNTRIES AND INDIA WITH THE GLOBAL ECONOMY

Country	Real trade as a share ^{1, 2} of GDP		Institutional investor credit rating ³		Net foreign direct investment as a share of PPP GDP ^{1, 4}		Manufactured exports as a share of total exports ⁵	
	Initial level % 1981-83	Annual average difference 1980-83 to 1980-93	Initial level 1981-83	Annual average difference 1980-83 to 1993-95	Initial level % 1981-83	Annual average difference 1980-82 to 1990-92	Initial level % 1981-83	Annual average difference 1981-83 to 1991-93
1. Indonesia	26.9	-1.40	51.0	0.06	0.1	0.02	3.2	3.81
2. India	7.4	0.09	46.6	-0.57	0.0	0.00	56.0	1.61

- Notes: 1. The ratio of trade to a country's Gross Domestic Product (GDP) as well as the share of foreign direct investment (FDI) flowing to developing countries are common measures of a country's integration with the global economy;
2. *Real trade* is the sum of exports and imports of goods and services measured in constant prices;
3. *Institutional investor credit rating* ranks the chances of a country's default from 0 to 100 representing the least chance of default;
4. *Net foreign direct investment* (FDI) is investment to acquire a lasting management interest (at least 10 per cent of voting stock) in an enterprise operating in a country other than that of the investor. Net FDI includes equity capital, reinvestment of earnings, other long-term capital, and short-term capital. The indicator is compared as a ratio to GDP converted to international dollars using purchasing power parities (PBPs);
5. *Manufactured exports* are commodities in the Standard International Trade Classification (SITC), revision 1, sections 5-9 (chemical and related products, basic manufactures, manufactured articles, machinery and transport equipment, and other manufactured articles and goods not elsewhere classified, excluding division 68 (non-ferrous metals).

Source: World Bank: *World Development Indicators 1997*, IEC Information Center, Development Data Group, 1997, Washington, D.C., Table 6.

larly, during the same period the share of net foreign direct investment in Indonesia's PPP GDP has been growing at a slightly positive rate, while that of India has remained stagnant. Moreover, the share of manufactured exports in Indonesia's total exports has during the same period also been growing at double the rate of India, even though during the initial period the share of manufactured exports in total exports was much higher in India than in Indonesia.

The only variable which shows a decrease for Indonesia's integration with the global economy is the that the annual average difference in the share of real trade in GDP of Indonesia has been negative, while that of India has been slightly positive. India's better performance in this regard has been due to the fact that the country since the early 1990s has been slowly opening up its economy after having pursued strongly inward-oriented policies for more than 40 years.

Conclusion

The dramatic events of the past eight months in Southeast Asia, including Indonesia, have shown clearly that "globalisation" has been a double-edged sword for these countries. While opening up the economies has undoubtedly led to more rapid economic growth and poverty alleviation in these countries, the destabilising effects of volatile short-term capital movements and of long-term portfolio capital movements (Arndt 1997: 2-5) should give ample reason to ponder whether the benefits of closer integration with the global economy do not outweigh its costs. Despite the fact that

the "economic fundamentals" of Indonesia were generally considered adequate, these conditions nevertheless did not shield it from the devastating effects of the currency crisis.

While the positive case for closer integration with the global economy still holds, as attested by the relatively good performance of the Indonesian economy during the past three decades, priority at the national level should be given to implementing the reform package as agreed upon with the IMF in January 1998 in a vigorous and determined way. This, in turn, will lead to a more stable and higher exchange rate of the rupiah, particularly if the large private sector debt is settled satisfactorily and the political uncertainty about the political succession has been lifted.

At the international level priority should be given to devise a workable and effective mechanism to regulate excessive capital inflows, as argued recently by the Sri Lankan economist Gamani Corea. Ideas in this direction have indeed been voiced by eminent economists, such as Professor James Tobin of Yale University, who has suggested that a tax (known as the Tobin tax) should be levied on capital movements across borders.

Aside from the merits or demerits of regulating international capital inflows, the experience of the Southeast Asian countries, including Indonesia, does show that a weakly supervised and undercapitalised banking system, domestic microeconomic policy-induced distortions, widespread corruption and unproductive rent-seeking activities, and venality of the government bureaucracy have corrosive effects which do not only undermine the foundations and resilience of a

national economy to weather external shocks, but also undermine the body politic and public confidence which are no less essential for a society and economy to weather big economic shocks successfully.

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A Review of Current and Capital Account Liberalisation in Indonesia

Hadi Soesastro

Introduction

INDONESIA began with the liberalisation of its economy about thirty years ago, following a change of government in 1966. The program then was not called "liberalisation". That would have sounded too much like an undertaking inspired by "liberalism", which until not too long ago was a dirty word in the Indonesian political jargon. Rather, the program was presented as a "total correction" of the economic policies of the previous government. This new direction or re-orientation of economic policies was to move away from etatism, thought to be one of the main causes of economic disaster that had befallen the country.

The process of liberalisation that began with this total correction did not proceed on a linear track. Along the way there were periods in which the process slowed down, or came to a halt, or even experienced a reversal. Yet on the whole, the economy has become much more open and more efficient, and the reforms have helped to sustain growth for three dec-

ades. Throughout the thirty years, there were three distinct periods of liberalisation, each being motivated by different events. What is remarkable is that throughout this entire period the country has been led by the same person, President Soeharto, who also makes the economic decisions with the assistance of a team of technocrats. In times of crisis, the technocrats' position is strengthened, but when times are good policies become rather lax. Macro-economic policies, that are under the control of the technocrats for most of the period, remain sound, but microeconomic policies have been much less coherent.

The first period, from 1966 to 1973, began with major liberalisation measures in an effort to rehabilitate an economy that was on the brink of a collapse. Macro-economic stabilisation was the immediate objective, and once this was achieved measures were taken to restructure the economy. These major "corrective" measures plus a total overhaul of the political system provided the legitimacy for the new government. The second liberalisation

period, from 1982 to about 1991, was essentially driven by necessity. The fall in oil prices forced the government to further restructure the economy, away from its dependence on oil revenues towards an economy that is internationally competitive in a broad range of non-oil, manufacturing products. The third period, from 1994 onwards, has been driven primarily by the emergence of a dynamic regional environment that is characterised by competitive liberalisation. This was reinforced by Indonesia's involvement in region-wide and global liberalisation initiatives through AFTA (the ASEAN Free Trade Area), the APEC (Asia Pacific Economic Cooperation) liberalisation agenda, and the WTO.

The intervening periods in which the liberalisation process slowed down, came to a halt, or experienced a reversal, are no less interesting to analyse. The identifiable periods of liberalisation trends and the intervening periods of increased protectionist policies are all closely linked to major economic and political changes (Pangestu, 1991). The story of Indonesia's economic liberalisation has not ended. The liberalisation agenda is far from being exhausted. A number of important areas, including agriculture and some upstream industries, have not been sufficiently touched by the liberalisation drive. Moreover, in an environment of competitive liberalisation this process tends to have a moving target. The economic and financial crisis that has hit Indonesia so severely since the latter half of 1997 could have a significant effect on the way this liberalisation process will be unfolding in the years to come.

Although most attention is currently being given to resolving the crisis, a number of questions regarding the wisdom and process of liberalisation have been raised by the wider public. Some believe that to a large extent the liberalisation of the current and capital accounts, the latter in particular, has been responsible for the crisis. The wrong sequencing of the reforms might have taken its toll. Others regard liberalisation as just the manifestation of a bigger process, namely globalisation. There is the concern that this globalisation process might have gone too far. Still others would address the issue of liberalisation mainly in terms of the increased (and unchecked) roles of the private sector in the economy. Finally there are those that link the issue of economic liberalisation with that of political liberalisation. These questions are not new but they are becoming more explicit now. It is in this context that the issues of current and capital account liberalisation facing Indonesia today can be best addressed. Two issues stand out. *First*, is the issue of how far, how fast and in what manner should liberalisation proceed? *Second*, is the issue of who gains and who loses from the liberalisation.

The First Issue

In undertaking the economic liberalisation Indonesia has never formulated any grand design to guide the process. It has been a process driven by pragmatism and by necessity. As such, the question of how far the process should go has never been made explicit. This is so because the government does not want to open up a de-

bate on what policy measures and reforms are in accordance with or are in violation of Article 33 of the 1945 Constitution. It would have been difficult to reconcile the reforms with the state-controlled economic system that is widely interpreted as being stipulated by the Constitution. An open debate on this matter could necessitate an amendment to the Constitution. This would risk creating precedence for amending other articles of the constitution, which could have serious ramifications for national cohesion and political stability. Therefore, the liberalisation policy was kept at the level of "low politics" (Soesastro, 1989). Since the mid-1980s the preferred label for the liberalisation agenda is "deregulation".

Packaged as a total correction of the policies of the previous government, the new government had no difficulties justifying the policies and programs adopted during the first period of liberalisation (1966-1972). To rehabilitate the economy, the new government moved decisively on restoring macroeconomic stability and introduced market-oriented reforms. It eliminated the fiscal deficit and introduced the balanced budget principle as a cornerstone of macroeconomic management, which is characterised by fiscal discipline. To deal with hyperinflation, a stringent monetary program was also adopted. Another major policy measure was to abandon the multiple exchange rate system in 1970, followed by a large devaluation in 1971 to bring the exchange rate to a realistic level. However, the most significant policy was the liberalisation of the capital account. Movements of capital were made totally free. This is contrary to the conventional wisdom on

the sequencing of economic reform in which the opening up of the capital account should come last. Sequencing of the reform measures was not an issue then. This policy was instituted mainly to give credibility to the government's commitment to its open door foreign investment policy. Indeed, as shown by experience, once the capital account is fully open it will not be easy for the government to reverse the policy, even only slightly, without risking serious misinterpretation on the part of foreign as well as domestic investors.

Market-oriented reforms were first introduced to change the trade and incentive regime. A significant step was the dismantling of the import licensing system. Although in 1968 tariffs on some products (e.g. textiles) were increased to encourage domestic production, import protection was considerably reduced from what it was before. The government also removed most domestic price controls. The open door investment policy was strengthened by the adoption of a Foreign Investment Law in 1967 that had no restrictions on foreign equity and employment of expatriates and allowed 100 per cent foreign ownership. The public supported these policies and programs with enthusiasm because they showed immediate results. Growth was restored and inflation was brought down, private initiatives were promoted and foreign capital plus aid were coming back.

However, a number of these policies and programs were subsequently reversed. The sudden upsurge of foreign direct investment (FDI), made so visible by the mushrooming of billboards and neon-light signs advertising Japanese consumer products,

aroused nationalist reactions that culminated in riots during the visit of the Japanese Prime Minister, Tanaka, to Indonesia in January 1974. As a result, investment regulations were made more restrictive. All new FDI had to be in the form of joint ventures with Indonesian equity to be increased to 51 percent within a specified period. The list of sectors closed to FDI was extended and tax incentives were reduced. There also was a shift back towards an increased role of the public sector in the economy. The oil booms of 1973-74 and 1979-80 enabled the public sector to expand. Public enterprises began to take a dominant role in a number of sectors, and public investments were increasingly directed into heavy industries, petrochemicals and mining. The civil service also expanded rapidly and bureaucratic interventions became rampant. Moreover, the incentive regime was made progressively more inward oriented. Distortions in the trade regime were reinforced by investment licensing and by credit allocation at subsidized interest rates (Bhattacharya and Pangestu, 1996). With the oil booms, the economy became heavily dependent on oil revenues and the government was faced with the "Dutch disease" problem, i.e. the erosion of the competitiveness of the non-oil economy due to the rise in the real exchange rate. The Dutch disease, the drop in oil prices, and world recession in the early 1980s eventually led to a recognition for the need to totally overhaul the economy. This opened up the way for the second period of liberalisation (1982-1990).

What lessons can be drawn thus far? On the positive side, compared to other

large oil exporting countries, Indonesia did not squander its new wealth. The oil windfall was used to reduce poverty, expand public education and health facilities, and promote rural development by allocating substantial resources to agriculture and rural infrastructure. Macroeconomic policies remained essentially sound. One could hypothesize that the very open capital account had imposed a discipline on macroeconomic management. The less positive side is that the liberalisation process was not pursued consistently and was largely influenced by events. One wonders whether this was due to the lack of a grand design for the liberalisation program. It is questionable, however, whether a blueprint for the process could have been drawn. In the final analysis, the process of economic liberalisation is political in its nature.

By taking full account of its political feasibility, the liberalisation process in the 1980s had to be undertaken in a gradual and pragmatic fashion. Ali Wardhana (1989), one of the main forces behind the liberalisation drive in the 1980s, argued for gradualism -- rather than the "big bang" approach -- because it has the advantage of progressively winning over a new constituency for further reform. He pointed out that the extended period of weak oil prices during the 1980s had made the gradual approach a viable option and enabled policy makers and implementors to work within their capacities to plan and execute reforms. Proponents of the big bang argued that their alternative would be more effective in preventing vested interests from rallying forces to oppose further reforms. Moreover, a big bang has

more credibility, as it would send strong signals regarding the government's commitment to the reforms. However, in a policy environment such as in Indonesia, where a great deal of doubt existed about the benefits of liberalisation, gradualism is the only viable option. The gradual approach can also be made credible by introducing a major reform in the beginning, to be followed by a clear action agenda and timetable for further liberalisation. Such agenda and timetable were the missing parts in Indonesia's liberalisation process of the 1980s.

As stated before, the liberalisation process in Indonesia has been driven largely by necessity and has been implemented pragmatically. It has been neither theory nor ideology driven. The universal trend in the 1980s towards economic liberalisation, deregulation, and privatisation may have provided an additional source of inspiration. Theories about the proper sequencing of reform programs have been widely espoused, but their adoption is a matter of political feasibility. The sequencing issue itself has been put forward because it would not be feasible or even desirable to undertake all reforms simultaneously.

The conventional wisdom suggests that current account liberalisation be undertaken only after having put in place or in conjunction with policies to ensure macroeconomic stability and exchange rate adjustment. Thus, macroeconomic stability is a prerequisite, but it also has to be maintained throughout the reform process. The main objective of current account liberalisation is to improve resources allocation and economy wide efficiency by removing dis-

tortions as well as to earn foreign exchange and improve the balance of payments by increasing exports and fostering efficient import substitution (Pangestu, 1990). This would be followed by reforms in the industrial sector, including foreign investment regulations, the transportation sector, and domestic regulations. Administrative reform is key to the success of the program. Liberalisation of the financial sector should follow the liberalisation of the real sector. Sequencing of financial sector liberalisation suggests that the strengthening of institutional, legal, and supervision capabilities should come first. Banking sector reform should come before capital market reform, and within capital markets, a domestic investor base should be strengthened before fully opening up to foreign participation. Finally, liberalisation of the capital account should come last. There are a number of arguments in support of this proposition. One concern is that capital flight during the reform process can aggravate or even stop the process. The other concern is that a liberalised capital account and financial sector reforms that precede the reforms of the real sector would only increase the flow of capital to sectors that are made attractive due to prevailing policy distortions.

In East Asia, Indonesia is the only country that began with the liberalisation of its capital account. As described earlier, this policy was taken in the early 1970s to make the country attractive for foreign investment. Indonesia's experience has often been cited as a "successful" case of a reverse in the order of economic liberalisation. One is perhaps less sure today that indeed this is the case. Yet, the open cap-

ital account had served the country well as it did help to impose a discipline in its macroeconomic management under difficult economic and domestic political pressures. In terms of the process of current account liberalisation, Indonesia has much in common with other East Asian countries. It has launched a series of export policy reforms before it undertook import reforms. In other words, it maintained import protection while promoting exports. Such facilities as duty drawback and export subsidies were introduced to offset the high cost economy created by the protection system. This policy did stimulate exports but it did not increase the overall economic efficiency. Moreover, this so-called "double-distortion policy" cannot be sustained under the present international trading environment. Import reforms should ideally begin with the removal of non-tariff barriers and replace them with equivalent tariffs that provide the same protection. This "tariffication" would increase transparency and reduce rent-seeking activities in addition to improving the allocation of resources. Following this tariffication, the tariff system should be rationalised with the aim of reducing the level and variance of tariffs to a progressively lower and relatively uniform nominal and effective rate of protection. While far from smooth, on the whole Indonesia's trade liberalisation has followed this pattern.

The second liberalisation period in Indonesia was undertaken in response to the significant drop in oil revenues. It was based on "a simple chain of economic reasoning" (Wardhana, 1989) which goes as follows. Economic growth and development require export growth to pay for

imports and to service debt. Reliable export growth requires non-oil exports from agriculture and manufacturing. Furthermore, non-oil exports require an efficient, productive economy, which needs a competitive domestic market. Protectionist policies and government controls are inimical to this competitive domestic market, creating a high-cost economy. Therefore, they need to be dismantled; i.e. the economy must be liberalised and deregulated. As a corollary, the government must develop non-oil revenues to be able to play a constructive role in development. The benefits of the liberalisation and the resulting economic growth must be widely and evenly spread and development of the rural areas should receive continued emphasis.

The reform process so conceived did not proceed smoothly. Indeed, this second liberalisation period began with some difficulties (Syahrir and Brown, 1992; Bhattacharya and Pangestu, 1996). The first half of this period, from 1982 to 1985, was characterised by ambivalence (Pangestu, 1991) and partial reforms (Hill, 1997). Substantial reforms were undertaken only in the second half of this period, namely from 1986 to about 1990. During this entire period no less than 20 policy packages were introduced to deregulate and liberalise the economy. The most significant of these measures were the trade liberalisation package of October 1986 and the financial liberalisation package of October 1988.

The dramatic drop in oil prices in 1986, and the currency realignment following the Plaza agreement in 1985 that resulted in an increase of Indonesia's external debt payments, appeared to have been responsible for precipitating and fueling a sense

of economic crisis that resulted in the more drastic measures. Prior to this heightened sense of crisis, the deregulation measures were not considered substantial, especially because the trade deregulation failed to address the issue of non-tariff barriers that were affecting a large proportion of imports. Import licensing that was re-introduced since the beginning of the 1980s became a major source of the high cost economy because it created opportunities for rent-seeking activities.

Current account liberalisation measures were first taken in 1982 in response to the deterioration in the country's balance of payments. Measures affecting trade, such as export taxes and restrictions on trade with the Socialist bloc were relaxed. A scheme for countertrade was also introduced. However, in an attempt to curb imports a licensing scheme was introduced in late 1982. The use of such import licensing proliferated rapidly. Until October 1986 close to 1,500 important items had come under some form of non-tariff barrier, usually a licensing restriction, which covered about 35 per cent of the value of total imports. The system became a vehicle for rent-seeking activities that led to the emergence of what Mancur Olson called "distributional coalitions". The system was also misused to promote the development of industries of questionable economic viability. The October 1986 package was a first serious attack on this system. It included the dismantling of the plastic and steel import monopolies, which were seen as the symbol of the then newly emerging cronyism.

Similarly, the financial deregulation initially only addressed problems of state

banks and did not affect the financial market as a whole. The October 1988 policy package on financial reforms, which has been widely regarded as the most sweeping reforms during this period, was aimed at increasing competition within the sector by removing some of the barriers to entry. State enterprises, which hitherto had to use only state banks, were now permitted to deposit up to 50 per cent of their funds in private banks. New foreign (joint venture) banks and domestic banks were allowed and foreign banks could open branches outside Jakarta. This liberalisation resulted in a dramatic growth of the financial sector. It has significantly altered the market structure and competitive situation facing the banking sector. The number of banks increased from 61 in 1988 to close to 120 in 1991, and to 230 in mid-1990s. The growth of assets and credits of private banks expanded rapidly and resulted in a dramatic increase in the role of private banks, especially domestic banks, at the expense of state banks.

This rapid growth in credits may have been responsible for the overheating of the economy in the late 1980s and the subsequent tightening of liquidity, which led to an increase in foreign borrowing that was facilitated by the open capital account. Leakage from abroad meant that despite the tight monetary policy money supply growth continued to be high and inflationary pressures increased. In 1991 the government began to take measures to manage offshore borrowing by putting a ceiling on the borrowing for government-related projects and borrowing by banks. The ceiling was put at about US\$5 to 6 billion for the next five years. Borrowing by

the private sector could not be directly controlled but the government indicated that an amount of up to US\$2 billion annually could be acceptable. As it turns out, private sector external borrowing increased rapidly and the accumulated debt amounted to over US\$70 billion in mid-1997. The limitation on offshore borrowing by banks resulted in direct borrowing by private corporations, and in turn to an over-borrowing due to predictability of the exchange rate depreciation and implicit guarantee of the government against currency depreciation.

Concerns were expressed about the possibility that the rapid expansion of bank credits could lead to financial distress and financial instability (Pangestu, 1993), in view of increased problem loans and bank failures. The open capital account was not at issue as it has been in place for some time. Rather, the concern is with the ability of the authorities to supervise the rapidly expanding banking sector. Efforts to strengthen bank prudential regulations were made in 1992 and in subsequent years. However, they appear to be far from adequate. Over the years the sweeping reforms in the financial sector of the late 1980s were evaluated with increased caution, but the prevailing attitude was to allow for some learning period on the part of both the new private banks and the Central Bank. In dealing with the increase in capital flows, a number of policy measures were taken. These included the gradual widening of the exchange rate band, limitation on offshore borrowing by non-bank financial institutions (NBFI), and closing off new licenses to NBFI. In addition reserve requirements were increased

from 2 to 3 per cent, and attempts were made to control lending to the property sector, initially through moral suasion, complemented by the setting of ceilings, and finally a moratorium was instituted in 1997. On top of this, a contractionary fiscal policy was adopted.

Although the process of liberalisation in the 1980s was widely supported in its broad outline, economists from the University of Indonesia expressed some concern over the widespread, simplistic notion that the reforms could provide a panacea for overcoming the high-cost economy and its many ills and inefficiencies. *First*, if the liberalisation of the current account is singularly pursued to promote non-oil exports, new distortions could be introduced. *Second*, a heavy focus on reforming the manufacturing sector can result in a bias against the agricultural sector. *Third*, the overall impact of the liberalisation has been positive primarily in psychological terms. *Fourth*, a closer examination needs to be undertaken on the impact of the reforms at the sectoral or industry level (Anwar and Aziz, 1988). There were increasing concern with the question of who gains and who loses in the process.

From 1991 to about the middle of 1994 the country experienced a "reform fatigue" (Iqbal, 1995) or a policy inertia (Hill, 1997). Efforts to further liberalise the current account appeared to have come to a halt. The average rate of nominal tariffs remained at the same level during much of this period. Things began to change in the middle of 1994 with the issuance of liberalisation measures in the investment field. This marked the beginning of a pro-

cess that was driven by the need to compete with other countries in the region that characterised the increased competitive liberalisation in East Asia.

The investment liberalisation measures of June 1994 allowed for 100 percent foreign ownership as a way to increase the attractiveness of Indonesia's investment regulation in the face of increased competition from China, Vietnam and other countries in the region. The government took note of the fall in investment approvals in 1993 and the slowdown in the growth of non-oil exports. In addition, nine sectors that were previously closed for FDI, including ports, power generation, shipping, air transport, railways, telecommunication, and initially even mass media, were opened up. In the trade field, a liberalisation package was issued in May 1995 which included a timetable for the reduction of tariffs of most tariff items up to the year 2003 and 2010. This was the first time the government came up with such a time-table for liberalisation. This unilateral liberalisation measure was issued in response to the competitive liberalisation environment in the region. In addition, it was to signal the government's determination to implement its commitments under AFTA, APEC and the WTO. These measures were further improved in June 1996. However, while on the whole significant progress has been achieved in reducing tariffs, a few sectors remain highly protected. The dismantling of the protection given to these sectors has become a difficult political issue. It no longer involves a competition of ideas on industrialisation and development among different ministries in the government. Rather, it became

a struggle to dismantle the cronyism that in the meantime has become so rampant and entrenched.

The crisis that hit Indonesia in the second half of 1997 was seen as an opportunity to redress this problem. Many in the government and the public in general regarded the crisis as a blessing in disguise as it could lead to renewed attempt to dismantle the monopolies and cronyism that became a source of the high cost economy. Having brought in the IMF to help resolve the crisis, the government negotiated a reform program that includes structural reforms, which are widely understood to aim at tackling the problem of cronyism that has become the major obstacle to the liberalisation process. The inclusion of these structural reforms in the IMF-supported reforms carries a risk in that the reforms might not be implemented in good faith. The dilemma, however, is that its exclusion would take away the credibility of the reform package (Soesastro and Basri, 1998). It remains to be seen whether these reforms, which have been negotiated over a period of six months, would help sustain the liberalisation process at least for the next three years.

The Second Issue

The issue of who gains and who loses from the liberalisation has become important because the future of the liberalisation process will depend on such a critical assessment by the body politic and the public at large. It is no longer sufficient for the government to show the overall favorable impact of the process. There is an urgent need to study this issue in

some depth in order to be able to respond to the growing popular beliefs or myths about the negative impacts of liberalisation and globalisation.

Hill (1997) noted some of these popular beliefs. Some have argued that the liberalisation (and deregulation) process has led to the creation of conglomerates and monopolies. Others have pointed to an increased inequality and poverty, as well as a widening of regional disparities. Still others are concerned about the demise of small firms. Hill gave an assessment on each of these propositions based on available empirical evidence to suggest that simplistic conclusions are faulty. A survey of perceptions in Indonesia, as reported in Socsastro (1997), indicated that liberalisation and globalisation might create problems particularly because they could lead to increased domination by foreign enterprises in the economy and a weakening of small and medium enterprises. A study by Iqbal (1995) examined the effects of the reforms upon firms according to the size distribution of firms. Realizing that there is the common perception that deregulation only benefits larger firms, he examined the probabilities of growing larger, or becoming smaller, or of exit for different categories of firms during the two periods, 1980-85 and 1986-91. The conclusion is that during the 1980s both large and small firms appear to have benefited from the reforms.

Perceptions are powerful and they have to be taken into account. There is an urgent need to study the impacts of the liberalisation and globalisation process in some depth in order to be able to respond to pop-

ular beliefs or myths about these impacts. The question of whether liberalisation has gone too far or has been undertaken too fast cannot be answered and addressed by studying its differential impacts on different sectors or segments in the society. There will always be a difference in impact, and there will be winners and losers. Identifying them would help devise the necessary institutions and develop the required policy instruments to deal with the negative impacts of liberalisation. This is the main challenge for Indonesia and other developing countries.

In analysing the issue of liberalisation in the context of the challenges of globalisation, developing countries like Indonesia are faced with two distinct types of adjustment. The first type of adjustment, which can be defined as the first order of adjustment, is the task of restructuring and liberalising the economy so as to be able to take part in and to benefit from the world economy (Socsastro, 1997). The first issue identified in this paper refers to this first order of adjustment. The second order of adjustment has to do with efforts to deal with the economic, social and political impacts of the first order of adjustment. Liberalisation of the economy has differential impacts on different groups and segments in the society. This calls for the development of new policy instruments and institutions that can help overcome the negative impacts of liberalisation. Short of this, it may be difficult to sustain the liberalisation process. It is in this regard that economic liberalisation might have to be supported by gradual political liberalisation as well.

Conclusion

The main issue facing Indonesia in its liberalisation process today is its ability to identify and develop institutions and policy instruments that are necessary to deal effectively with a much more complex policy environment resulting from economic liberalisation. The bottom line is that there is no alternative to sustaining the liberalisation process. The agenda, in a sense, has shifted from the first order of adjustment to the second order of adjustment.

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Contributors

- **Ignasius Ismanto.**

Researcher in the Department of Social and Political Affairs, CSIS. He graduated from the Faculty of Social and Political Science, Gadjah Mada University, Yogyakarta (1983) and obtained his MA in Public Policy at Gadjah Mada University (1994) and Murdoch University Perth, Western Australia (1997).

- **Mayling Oey-Gardiner.**

Executive Director, Insan Hitawasana Sejahtera, Social Science Research & Consultancy Indonesia.

- **Jusuf Wanandi.**

Chairman of the Supervisory Board, CSIS. Member of the Board of Governors, East West Centre, Honolulu, Hawaii. He graduated from the Faculty of Law and Social Sciences, University Indonesia (1960). In 1977 he was Congressional Fellow sponsored by American Political Science Association (APSA).

- **Simon S.C. Tay.**

LLB Hons (National University of Singapore), LLM (Harvard). He teaches international and public law at the National University of Singapore, with a focus on the environment and human rights. He also serves as a Nominated member of the Singaporean Parliament and on the board of a number of non-governmental organizations, including the Singapore Institute of International Affairs and the Singapore Environmental Council.

- **Fritz E. Simandjuntak.**

Sociologist, Manager of Communications and External Relations IBM Indonesia, Member of Nusantara 21 Steering Committee, and Director of Association of National Enterprise in Informatics.

- **Thee Kian Wie.**

Senior Researcher in the Centre for Economic and Development Studies, Indonesian Institute of Sciences (PEP-LIPI), Jakarta.

- **Hadi Soesastro.**

Member of the Board of Directors, CSIS Jakarta. He obtained his Dipl.Eng from the Faculty of Aeronautical Engineering, Rheinisch-Westphälische Technische Hochschule, Aachen, the Federal Republic of Germany (1971), and Ph.D in Policy Analysis from the Rand Graduate School of Policy Studies, Santa Monica, California, USA (1978).

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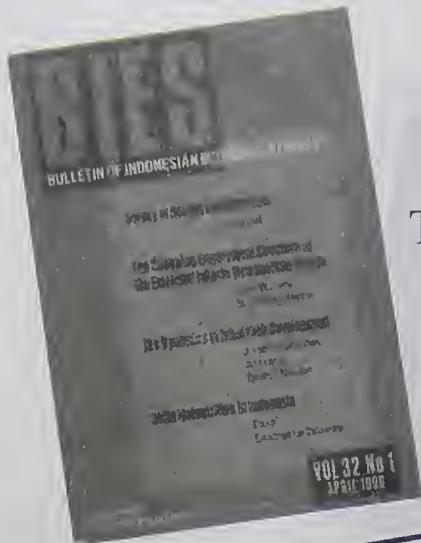
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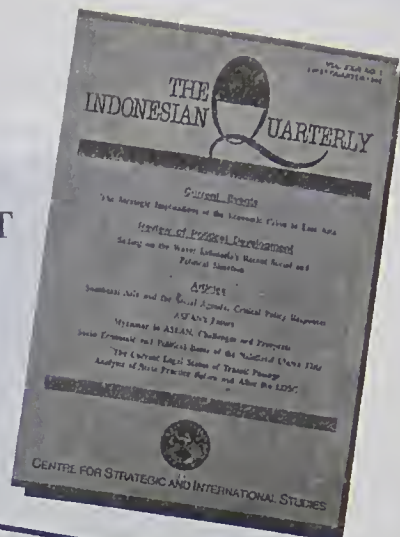


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